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Gale Group PROMT®, File 160 (1972-1989)

Gale Group Trade & Industry Database , File 148 (1976 - present)

Gale Group Computer Database , File 275 (full-text 1/1988 - present)

Business Wire, File 610 (Mar 1999 - present)

Business Wire, File 810 (1986 - February 1999)

Core FT2:

Dialog Global Reporter, File 20 (May 1997 - present)

The McGraw-Hill Companies Publications Online, File 624 (1985 - present)

Gale Group New Product Announcements/Plus® (NPA/Plus, File 621 (1985 - present)

Gale Group Newsletter Database , File 636 (1988 - present)

PR Newswire, File 613 (May 1999 - present)

San Jose Mercury News, File 634 (Jun 1985 - present)

PR Newswire, File 813 (May 1987 - May 1999)

Sub35FT:

McClatchy-Tribune Information Service, File 608 (Jan 1989 - present)

American Banker Financial Publications, File 625 (1981 - June 2008)

Banking Information Source, File 268 full-text (1994 - present)

Bond Buyer Full Text, File 626 (November 1981 - April 2008)

DIALOG Finance & Banking Newsletters, File 267 (1996 - present)

Set#	Query
L1	float$3 with rate$1 with note$
L2	variable with rate with obligation$
L3	taxable with float$3 with rate$1 with note$

L4	debt adj3 obligation$2
L5	(tax adj exempt) with bond
L6	municipality
L7	collateral
L8	purchas$3 with asset$2
L9	variable adj rate adj demand adj obligation$
L10	security with interest$1
L11	(interest investment) with default
L12	l1 and l2 and l5 and l6 and l7 and l8 and l10 and l11
L13	l1 or l3
L14	l2 or l4 or l9
L15	l10 or l11
L16	l13 and l14 and l15
L17	l5 and l16
L18	l6 and l16
L19	l7 and l16
L20	l8 and l16
L21	l5 and l6 and l7 and l8
L22	l21 and l16

109/9/1 (Item 1 from file: 20)
38487319
Sovereign Bancorp, Inc. Announces 2004 Third Quarter Net Income of $83 Million, Record Operating Income of $143 Million and Cash Earnings of $162 Million

PR NEWSWIRE (US)
October 19, 2004
Journal Code: WPRU **Language:** English **Record Type:** FULLTEXT
Word Count: 8450

PHILADELPHIA, Oct. 19 /PRNewswire-FirstCall/ -- Sovereign Bancorp, Inc. ("Sovereign") , parent company of Sovereign Bank ("Bank"), today reported third quarter 2004 net income after non-recurring charges of $60.8 million, or $.18 per share, of $82.5 million, or $.24 per diluted share, as compared to $109 million, or $.37 per diluted share, for the third quarter of 2003. Net income in the third quarter of 2004 included the previously announced after-tax merger and integration charge of $18.2 million, or $.05 per share, associated with the acquisition of Seacoast

Financial Services Corporation ("Seacoast") and an after-tax charge of $42.6 million, or $.13 per share, in connection with the early redemption of $500 million of high-cost debt.

Excluding these charges, operating earnings were up 31% to $143 million as compared to $109 million for the third quarter of 2003. Operating earnings per share were up 14% to $.42 per share from $.37 per share during the third quarter of 2003. Cash earnings increased to $162 million, or $.47 per diluted share, as compared to $124 million, or $.42 per diluted share, for the third quarter of 2003. A reconciliation of net income, operating earnings and cash earnings, as well as the related earnings per share amounts, is included in a later section of this release.

Commenting on results for the third quarter of 2004, Jay S. Sidhu, Sovereign's Chairman and Chief Executive Officer, said, "The third quarter was another strong quarter for Sovereign. We are pleased that the Federal Reserve has begun to increase short-term interest rates, as this immediately benefited our net interest income and should also drive net interest margin expansion in the fourth quarter. Commercial and consumer loans were up 9% and 28%, respectively, from the third quarter of 2003, excluding the impact of acquisitions; while core deposits were up 6%. Our credit quality again showed improvement during the quarter. Operating expenses are being held in check, as the only increases in expenses for the quarter were related to our acquisition of Seacoast. Lastly, we are pleased to welcome Seacoast's customers, shareholders and team members to Sovereign, as we successfully closed and converted this acquisition during the quarter."

September of this year marked the five-year anniversary of Sovereign's announcement of the Fleet/BankBoston branch acquisition, the largest banking divestiture in U.S. history. It consisted of 285 branches, $12 billion in deposits and $9 billion in loans. This acquisition enabled Sovereign to enter the New England market with a very significant market share, ranking third in the region. Since Sovereign's successful integration in the third quarter of 2000, the annual growth rate in operating earnings per share has been 10%, and since 2001, Sovereign's operating earnings annual growth rate has been 25%. Since the third quarter of 2000, Sovereign's commercial and consumer loans have grown 14% and 20%, respectively, on average per year. Core deposits have grown 15% on average per year. Banking fees have increased 30% on average per year. Operating expenses have increased only 1.5% on average per year. Sovereign's efficiency ratio has decreased more than 500 basis points. Capital levels have improved substantially. Equity to assets has expanded 315 basis points to 8.64% at September 30, 2004. Tier 1 Leverage has expanded 356 basis points to 6.56% at September 30, 2004. Tangible common equity has expanded 315 basis points to 4.51% at September 30, 2004. In addition to dramatically improved capital levels, the quality of Sovereign's balance sheet has improved as Sovereign has removed most of the high-cost debt financing incurred in this transaction. "This acquisition transformed Sovereign into a high growth community-oriented commercial bank with a diversified loan portfolio, a low-cost deposit base and a very strong market position. It has substantially enhanced franchise and shareholder value. This is evidenced by a 145% appreciation in our stock price since October of 1999, outperforming a number of market indices including the DJIA, S&P 500, Bank Super regional, Bank NYSE and Thrift NYSE during that time period," commented Sidhu.

Net Interest Income and Margin

Sovereign reported net interest income of $363 million for the third quarter of 2004, an increase of $75.7 million, or 26% compared to the third quarter of 2003. On a linked-quarter basis, net interest income increased by $30.9 million, or 9.3%, in spite of the fact that the company de-levered the investment portfolio by $1.1 billion. As a result of higher short-term interest rates, commercial loan yields increased by 36 basis

points and consumer loan yields increased by 10 basis points during the quarter. Most of Sovereign's variable rate consumer loans have repricing periods that lag rate changes by up to one quarter. Deposit costs increased by only 14 basis points in the third quarter.

During the quarter, Sovereign successfully redeemed $500 million of 10.50% senior notes and replaced them with lower-cost, unsecured senior debt much more reflective of the financial strength of Sovereign today. The 10.50% senior **notes** that were redeemed carried a cost of approximately 8.18%, as $400 million of the debt was swapped to **floating rate** at a cost of Libor + 550 basis points. Sovereign funded this redemption with cash on hand and a new two-year senior **note** issue of $300 million at a **floating rate** of Libor + 33 basis points.

Net interest margin was 3.17% for the third quarter of 2004, compared to 3.22% in the second quarter of 2004 and 3.32% in the third quarter of 2003, primarily impacted by the flattening of the yield curve. Commenting on third quarter net interest margin, James D. Hogan, Sovereign's Chief Financial Officer, noted, "As we have previously stated, Sovereign's net interest income has benefited from the quarter's short-term interest rate hikes. However, meaningful net interest margin expansion requires 100 basis points or more of rate hikes, as replacement yields on new loan production are still lower than the assets running off due to the flattening of the yield curve. Our fourth quarter outlook for both net interest income and net interest margin is positive, as the fourth quarter will reflect a full quarter's benefit of three 25 basis point rate hikes by the Federal Reserve as well as the impact of our debt redemption, which was completed late in September."

Non-Interest Income

Sovereign's consumer and commercial banking fees generated record levels once again in the third quarter of 2004. Consumer banking fees increased by $9.2 million, or 17%, compared to the same period in 2003. The increase was driven principally by deposit fees, which increased by $7.0 million to $51.3 million. Commercial banking fees increased $4.6 million to $31.8 million, or 17%, over the same period a year ago driven by growth in loan fees. Consumer and commercial banking fees increased 8% and 4%, respectively, in the third quarter of 2004 as compared to second quarter 2004 levels. Excluding approximately $3.7 million in revenue related to Seacoast, consumer and commercial banking fees increased 11.0% and 15.4%, respectively, over last year.

Mortgage banking revenues for the quarter were a loss of $4.1 million, compared to revenues of $16.4 million last quarter and $17.5 million a year ago. Due to changes in prepayment speeds and interest rates, a servicing rights impairment charge of $9.4 million was recorded in the third quarter of 2004. This compares to reversals of valuation reserve recorded in the second quarter of 2004 and the third quarter of 2003 of $17.1 million and $18.3 million, respectively. Hogan noted, "Excluding an impairment charge this quarter and reversals of the valuation reserve related to mortgage servicing rights in the previous comparable quarters, mortgage banking revenues were $5.3 million in the third quarter of 2004 as compared to slight losses of $.7 million in the second quarter of 2004 and $.8 million in the third quarter of 2003." Mortgage banking results are summarized in the financial tables attached to this release. As of September 30, 2004, mortgage servicing rights, net of reserves of $10.9 million, were $74.0 million and our servicing portfolio was $6.5 billion, with a capitalized cost of 114 basis points.

Sovereign has attempted in recent quarters to minimize fee income volatility by realizing gains on sales of investments to offset mortgage banking declines resulting from servicing right impairment charges, as these two revenue sources have characteristics that offset each other. This is evidenced by third quarter and second quarter 2004 combined revenue from mortgage banking revenue and securities gains of $16.2 million and $17.3 million, respectively.

Non-Interest Expense

G&A expenses for the quarter were $238 million, up 5.8% from $225 million in the second quarter and up 13% from $211 million a year ago. Excluding operating expenses during the quarter of approximately $18.0 million related to Seacoast, G&A expenses decreased $5.0 million from the second quarter of 2004. Hogan stated, "In the third quarter, our efficiency ratio was 50.4% versus 49.2% in the second quarter of 2004 and 51.8% in the third quarter of 2003. Most of the increase we've seen in our efficiency ratio is a result of weak mortgage banking results, as well as the timing of systems conversions related to our acquisition of Seacoast. A portion of Seacoast was converted at closing on July 23, 2004, while a more significant portion was not converted until the weekend of October 15th. We have committed to improving our efficiency ratio by 100 basis points in 2004 and we are ahead of schedule in fulfilling that commitment."

Sovereign's effective tax rate declined in the third quarter to 17.2% on a GAAP basis due to reduced pre-tax income resulting from the debt redemption and Seacoast merger charges incurred during the quarter, which were both tax benefited at 35%. On an operating basis, Sovereign's effective tax rate was 25.8% in the third quarter. Sovereign's full-year 2004 effective tax rate is expected to be approximately 26% on an operating basis, since all of Sovereign's operating adjustments are tax benefited at 35%.

Franchise Growth

Sovereign's total loan portfolio increased during the third quarter by $6.1 billion to $35.3 billion, $4.1 billion of which was a result of the Seacoast acquisition. Organic loan growth was $2.0 billion during the quarter. Consumer loans have increased 28% over the third quarter of last year, while commercial loans have increased 9%, excluding the impact of acquisitions. Commercial and consumer loans now make up 38% and 39%, respectively, of the total loan portfolio. The following table depicts Sovereign's loan composition as of September 30, 2004 ($ in millions): Loan Category Ending Balance Q3 2004 Yield Q2 2004 Yield Q3 2004 % of Loans Commercial $13,446 4.91% 4.55% 38.1% Consumer 13,857 5.10% 5.00% 39.3 Residential mortgage 7,959 5.21% 5.57% 22.6 Total $35,262 5.05% 4.90% 100%

Core deposits increased $2.9 billion during the quarter to $25.7 billion; excluding the Seacoast acquisition, core deposits grew $468 million, or 8.2% annualized, during the quarter. Total deposits increased $4.1 billion during the quarter to $33.1 billion; $3.6 billion of the increase was a result of the Seacoast acquisition. Time deposits account for only 22% of total deposits at September 30, 2004. The following table summarizes Sovereign's deposit position as of September 30, 2004 ($ in millions): Deposit Category Ending Balance Q3 2004 Cost Q2 2004 Cost Q3 2004 % of Total Deposits Checking $13,669 0.57% 0.40 % 41.3% Other core (MMDA & Savings) 12,075 0.97% 0.80 % 36.5 Total Core 25,744 0.76% 0.59% 77.8 Time deposits 7,358 2.04% 2.04% 22.2 Total deposits $33,102 1.04% .90% 100% Asset Quality

Sovereign's credit quality continued to improve in the third quarter of 2004. Non-performing assets ("NPAs") declined $7 million during the quarter to $169 million at September 30, 2004; this includes $17.5 million of non-performing loans added as a result of the Seacoast acquisition. NPAs to total assets decreased to .30% during the third quarter of 2004, compared to .36% at June 30, 2004. Sovereign's provision for loan losses was $25.0 million this quarter compared to $32.0 million in the second quarter and $36.6 million in the third quarter of 2003. The allowance for loan losses to total loans decreased to 1.15% at September 30, 2004, as compared to 1.21% at June 30, 2004 and 1.31% at September 30, 2003, due to improved credit quality and a shift towards a lower risk loan portfolio due to the acquisition of Seacoast. Coverage of non-performing loans improved significantly during the quarter. The allowance for loan losses to non-performing loans now stands at 276%, as compared to 232% at June

30, 2004 and 137% at September 30, 2003.

Capital

Sovereign's Tier 1 leverage ratio was 6.56% at September 30, 2004. Tangible common equity to tangible assets was 4.51%. Tangible common equity to tangible assets, excluding other comprehensive income ("OCI"), was 4.77%. The equity to assets ratio was 8.64% at September 30, 2004. Sovereign Bank's Tier 1 leverage ratio was 6.62% and the bank's risk-based capital ratio was 11.34% at September 30, 2004.

Accounting Changes

On September 30, 2004, the Emerging Issues Task Force (EITF) reached a consensus on EITF 04-8 "Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share," which eliminated certain accounting benefits of convertible debt with contingent conversion features by requiring such instruments to be accounted for under the if-converted method for diluted earnings per share purposes. Issuers whose contingent convertible debt can be settled in stock will be required to increase the number of shares used in diluted earnings per share calculations by the total number of shares underlying the contingent convertible debt, regardless of conversion price. Many companies, including Sovereign, are retroactively affected by this accounting change. Sovereign issued $800 million of contingently convertible trust preferred equity income redeemable securities in the first quarter of 2004. Effective in the fourth quarter 2004, Sovereign will be required to adopt EITF 04-8 and as a result, prior period earnings per share will be required to be restated. Sovereign expects this accounting change to result in a downward restatement of year-to-date prior period diluted GAAP earnings per share from $.99 to $.97. A reconcilement of quarterly GAAP, earnings per share, including the anticipated impact of EITF 04-8, is included in a later section of this release.

Looking Ahead

"We continue to be comfortable with management's guidance of $1.65 to $1.70 in operating earnings per share and approximately $1.85 to $1.90 in cash earnings per share for 2004, excluding the $.03 to $.04 anticipated impact of EITF 04-8 described above, after-tax merger related charges of $.12 for our completed acquisitions of First Essex and Seacoast and $.13 in connection with the debt redemption," Sidhu commented. "We are also comfortable with the analysts' mean estimate of $1.91 per share for 2005, which implies an operating earnings growth of 14%. In spite of recent accounting changes, which will impact 2005 earnings per share $.05 to $.06, management's goal remains to strive for $1.90 to $2.00 in operating earnings per share, excluding after-tax merger related charges of $.04 to $.06 for our pending acquisition of Waypoint, which is expected to close in January 2005." A reconcilement of GAAP, operating, and cash earnings per share is included in a later section of this release.

Based upon our October 18 stock price of $21.54, Sovereign is trading at a P/E of 11.3x analysts' mean 2005 estimate of operating earnings per share, a P/E of 10.4x for implied 2005 cash earnings per share and 154% of current book value. The book value per share at September 30, 2004 was $13.95.

Sovereign Bancorp, Inc., ("Sovereign") , is the parent company of Sovereign Bank, pro forma a $60 billion financial institution with more than 650 community banking offices, over 1,000 ATMs and approximately 9,500 team members in Connecticut, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania and Rhode Island. In addition to full-service retail banking, Sovereign offers a broad array of financial services and products including business and corporate banking, cash management, capital markets, trust and wealth management and insurance. Pro forma for pending acquisitions, Sovereign is the 18th largest banking institution in the United States. For more information on Sovereign Bank, visit http://www.sovereignbank.com/ or call 1-877-SOV-BANK.

Interested parties will have the opportunity to listen to a live

web-cast of Sovereign's Third Quarter 2004 earnings call on Wednesday, October 20 beginning at 8:30 a.m. ET at >Investor Relations >News >Conference Calls/Webcasts; or

http://www.firstcallevents.com/service/ajwz410086127gf12.html. The web-cast replay can be accessed anytime from 11:00 a.m. ET on October 20, 2004 through 12 a.m. ET (midnight) on December 15, 2004. Questions may be submitted during the call via email to investor@sovereignbank.com. A telephone replay will be accessible from October 20, 2004 - October 25, 2004 by dialing 1-800-642-1687, and confirmation id#1093191.

Note:

This press release contains financial information determined by methods other than in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"). Sovereign's management uses the non-GAAP measures of Operating Earnings and Cash Earnings, and the related per share amounts, in their analysis of the company's performance. These measures, as used by Sovereign, adjust net income determined in accordance with GAAP to exclude the effects of special items, including significant gains or losses that are unusual in nature or are associated with acquiring and integrating businesses, and certain non-cash charges. Operating earnings represent net income adjusted for the after-tax effects of merger-related and integration charges and the loss on early extinguishment of debt. The forward-looking operating earnings guidance for 2004 excludes the anticipated impact of EITF 04-8, which will be effective in the fourth quarter of 2004. Cash earnings are operating earnings excluding the after-tax effect of amortization of intangible assets and stock-based compensation expense associated with stock options, restricted stock, bonus deferral plans and ESOP awards. Since certain of these items and their impact on Sovereign's performance are difficult to predict, management believes presentations of financial measures excluding the impact of these items provide useful supplemental information in evaluating the operating results of Sovereign's core businesses. These disclosures should not be viewed as a substitute for net income determined in accordance with GAAP, nor are they necessarily comparable to non-GAAP performance measures that may be presented by other companies.

This press release contains statements of Sovereign's strategies, plans, and objectives, as well as estimates of future operating results for 2004 and beyond for Sovereign Bancorp, Inc. as well as estimates of financial condition, operating efficiencies and revenue generation. These statements and estimates constitute forward-looking statements (within the meaning of the Private Securities Litigation Reform Act of 1995), which involve significant risks and uncertainties. Actual results may differ materially from the results discussed in these forward-looking statements. Factors that might cause such a difference include, but are not limited to, general economic conditions, changes in interest rates, deposit flows, loan demand, real estate values and competition; changes in accounting principles, policies, or guidelines; changes in legislation or regulation; Sovereign's ability in connection with any acquisition to complete such acquisition and to successfully integrate assets, liabilities, customers, systems and management personnel Sovereign acquires into its operations and to realize expected cost savings and revenue enhancements within expected time frame; the possibility that expected one time merger-related charges are materially greater than forecasted or that final **purchase** price allocations based on the fair value of acquired **assets** and liabilities and related adjustments to yield and/or amortization of the acquired assets and liabilities at any acquisition date are materially different from those forecasted; and other economic, competitive, governmental, regulatory, and technological factors affecting the Company's operations, integrations, pricing, products and services. Sovereign Bancorp, Inc. and Subsidiaries FINANCIAL HIGHLIGHTS (unaudited) Quarter Ended Sept. 30 June 30 Mar. 31 Dec. 31 Sept. 30 2004 2004 2004 2003 2003 (dollars in millions, except per share data) Operating Data Net income $82.5 $131.4 $102.2 $112.6 $109.2 Operating earnings (1) 143.3

131.4 121.5 112.6 109.2 Cash earnings (2) 161.6 147.2 136.9 127.3 124.4
Net interest income 363.0 332.0 322.8 308.5 287.3 Provision for loan
losses 25.0 32.0 43.0 40.0 36.6 Total fees and other income before
securities transactions 108.3 124.2 109.1 121.2 119.5 Net gain on
investment securities 20.2 0.8 17.9 10.2 18.8 G&A expense 237.7 224.6
223.1 217.6 210.8 Other expenses (3) 129.1 28.1 48.6 27.4 27.5 Performance
Statistics Bancorp Net interest margin (3) 3.17% 3.22% 3.28% 3.39% 3.32%
Cash return on average assets (2) 1.20% 1.23% 1.20% 1.18% 1.20% Operating
return on average assets (1) 1.07% 1.10% 1.07% 1.05% 1.05% Cash return on
average equity (2) 14.14% 15.26% 15.47% 15.94% 15.97% Operating return on
average equity (1) 12.55% 13.62% 13.72% 14.10% 14.03% Annualized net loan
charge-offs to average loans 0.25% 0.43% 0.51% 0.55% 0.55% Efficiency
ratio (3) (4) 50.44% 49.22% 51.67% 50.65% 51.82% Per Share Data Basic
earnings per share $0.25 $0.43 $0.34 $0.38 $0.37 Diluted earnings per
share 0.24 0.42 0.33 0.38 0.37 Operating earnings per share (1) 0.42 0.42
0.40 0.38 0.37 Cash earnings per share (2) 0.47 0.47 0.45 0.43 0.42
Dividend declared per share .030 .030 .025 .025 .025 Book value (5) 13.95
12.46 12.78 11.12 10.84 Common stock price: High 22.48 22.10 24.51 24.99
19.68 Low 20.48 19.51 20.37 18.42 15.74 Close $21.82 $22.10 $21.42 $23.75
$18.55 Weighted average common shares: Basic 335.6 306.1 300.7 292.5 292.2
Diluted 341.7 311.7 306.7 298.5 297.2 End-of-period common shares: Basic
345.3 306.2 306.4 293.1 292.3 Diluted 351.2 312.1 311.7 299.4 297.4
Sovereign Bancorp, Inc. and Subsidiaries FINANCIAL HIGHLIGHTS (unaudited)
Year to Date Sept. 30 Sept. 30 2004 2003 (dollars in millions, except per
share data) Operating Data Net income $316.1 $289.3 Operating earnings (1)
396.1 308.1 Cash earnings (2) 445.6 354.4 Net interest income 1,017.8
897.1 Provision for loan losses 100.0 122.0 Total fees and other income
before securities transactions 341.6 334.4 Net gain on investment
securities 39.0 55.8 G&A expense 685.4 634.7 Other expenses (3) 205.7
130.6 Performance Statistics Bancorp Net interest margin (3) 3.22% 3.43%
Cash return on average assets (2) 1.21% 1.16% Operating return on average
assets (1) 1.08% 1.00% Cash return on average equity (2) 14.90% 16.13%
Operating return on average equity (1) 13.24% 14.02% Annualized net loan
charge-offs to average loans 0.39% 0.55% Efficiency ratio (3) (4) 50.42%
51.54% Per Share Data Basic earnings per share $1.01 $1.06 Diluted
earnings per share 0.99 1.01 Operating earnings per share (1) 1.24 1.07
Cash earnings per share (2) 1.39 1.23 Dividend declared per share 0.085
0.075 Book value (5) 13.95 10.84 Common stock price: High 24.51 15.57 Low
19.51 11.85 Close $21.82 $12.90 Weighted average common shares: Basic
314.4 272.1 Diluted 320.3 287.7 End-of-period common shares: Basic 345.3
292.3 Diluted 351.2 297.4 NOTES: (1) Operating earnings represent net
income excluding the after-tax effects of special items, including
significant gains or losses that are unusual in nature or are associated
with acquiring or integrating businesses. See reconciliation on page I.
(2) Cash earnings represents operating earnings excluding the after-tax
effects of non-cash charges for the amortization of intangible assets and
stock based compensation. Stock based compensation encompasses
arrangements with employees under which the Company's obligation will be
settled by using stock rather than cash and includes expense related to
stock options, restricted stock, bonus deferral plans, and ESOP expense.
See reconciliation on page I. (3) Effective July 1, 2003, Sovereign
elected to change the Company's accounting policy to treat trust preferred
securities as liabilities and the associated dividends on the trust
preferred securities as interest expense. Previously, this cost was
classified within other expenses. This change in accounting policy did not
have any impact on consolidated shareholders' equity or net income;
however, it did result in an increase in liabilities of $207.6 million at
July 1, 2003 and an increase of $5 million and $3 million in net interest
expense, with a corresponding decrease in other expense, for the
three-month periods ended September 30, 2003 and December 31, 2003,
respectively. Prior periods have not been adjusted to conform with this
change in accounting policy. (4) Efficiency ratio equals general and

administrative expense as a percentage of total revenue, defined as the sum of net interest income and total fees and other income before securities transactions. (5) Book value equals stockholders' equity at period-end divided by common shares outstanding. Sovereign Bancorp, Inc. and Subsidiaries FINANCIAL HIGHLIGHTS (unaudited) Quarter Ended Sept. 30 June 30 Mar. 31 Dec. 31 Sept. 30 2004 2004 2004 2003 2003 (dollars in millions) Financial Condition Data: General Total assets $55,755 $48,687 $47,043 $43,505 $41,055 Loans 35,262 29,130 27,739 26,149 24,550 Total deposits and customer related accounts: 33,102 29,001 28,118 27,344 27,515 Core deposits and other customer related accounts 25,744 22,824 21,939 21,334 21,233 Time deposits 7,358 6,176 6,179 6,010 6,283 Borrowings 16,919 15,157 14,262 12,198 9,570 Minority interests 203 203 203 202 202 Stockholders' equity 4,815 3,815 3,916 3,260 3,169 Goodwill 2,103 1,289 1,293 1,027 1,027 Core deposit intangible 305 249 262 269 287 Asset Quality Non-performing assets $168.8 $176.1 $212.0 $220.4 $257.7 Non-performing loans $147.5 $152.2 $188.6 $199.4 $236.1 Non-performing assets to total assets 0.30% 0.36% 0.45% 0.51% 0.63% Non-performing loans to total loans 0.42% 0.52% 0.68% 0.76% 0.96% Allowance for loan losses $406.6 $352.6 $351.0 $327.9 $322.7 Allowance for loan losses to total loans 1.15% 1.21% 1.27% 1.25% 1.31% Allowance for loan losses to non-performing loans 276% 232% 186% 164% 137% Capitalization - Bancorp (1) Stockholders' equity to total assets 8.64% 7.84% 8.32% 7.49% 7.72% Tier 1 leverage capital ratio 6.56% 7.13% 7.12% 5.61% 5.60% Tangible equity to tangible assets, excluding OCI 4.77% 5.28% 5.19% 4.80% 4.73% Tangible equity to tangible assets, including OCI 4.51% 4.83% 5.19% 4.66% 4.67% Capitalization - Bank (1) Stockholders' equity to total assets 10.20% 9.12% 9.60% 8.99% 9.49% Tier 1 leverage capital ratio 6.62% 6.85% 6.82% 6.66% 6.96% Tier 1 risk-based capital ratio 8.42% 8.92% 8.82% 8.60% 8.65% Total risk-based capital ratio 11.34% 12.12% 12.13% 12.12% 12.20% (1) All capital ratios are calculated based upon adjusted end of period assets consistent with OTS guidelines. The current quarter ratios are estimated as of the date of this earnings release. Sovereign Bancorp, Inc. and Subsidiaries CONSOLIDATED BALANCE SHEETS (unaudited) Sept. 30 June 30 Mar. 31 (dollars in thousands) 2004 2004 2004 Assets Cash and amounts due from depository institutions $1,266,044 $1,026,719 $893,193 Investments: Available-for-sale 10,111,845 10,493,897 11,912,292 Held-to-maturity 4,027,472 4,007,041 2,489,030 Total investments 14,139,317 14,500,938 14,401,322 Loans: Commercial 13,445,735 12,251,456 11,919,975 Consumer 13,856,992 11,986,107 11,012,103 Residential mortgages 7,958,974 4,892,305 4,806,494 Total loans 35,261,701 29,129,868 27,738,572 Less allowance for loan losses (406,612) (352,637) (351,007) Total loans, net 34,855,089 28,777,231 27,387,565 Premises and equipment, net 352,089 286,682 289,517 Accrued interest receivable 225,918 196,347 188,002 Goodwill 2,103,158 1,289,340 1,292,809 Core deposit intangible 304,754 249,169 261,582 Bank owned life insurance 879,189 851,155 841,568 Other assets 1,629,450 1,509,296 1,487,657 Total assets $55,755,008 $48,686,877 $47,043,215 Liabilities and Stockholders' Equity Liabilities: Deposits and other customer related accounts: Core and other customer related accounts $25,743,796 $22,824,310 $21,939,435 Time deposits 7,357,882 6,176,310 6,178,871 Total 33,101,678 29,000,620 28,118,306 Borrowings and other **debt obligations** 16,919,164 15,157,017 14,261,686

Other liabilities 715,326 511,131 545,084 Total liabilities 50,736,168 44,668,768 42,925,076 Minority interests 203,488 202,919 202,513 Stockholders' equity: Common Stock 2,934,733 2,105,312 2,102,183 Warrants and stock options 318,874 306,594 305,297 Unallocated ESOP shares (26,078) (26,078) (26,078) Treasury stock (19,767) (20,242) (22,190) Accumulated other comprehensive income/ (loss) (136,645) (222,499) 6,349 Retained earnings 1,744,235 1,672,103 1,550,065 Total stockholders' equity 4,815,352 3,815,190 3,915,626 Total liabilities and stockholders' equity $55,755,008 $48,686,877 $47,043,215 Sovereign Bancorp, Inc. and Subsidiaries CONSOLIDATED BALANCE SHEETS (unaudited) Dec. 31 Sept. 30 (dollars in thousands) 2003 2003 Assets Cash and amounts due from

depository institutions $950,302 $971,697 Investments: Available-for-sale 10,102,619 11,109,603 Held-to-maturity 2,516,352 413,152 Total investments 12,618,971 11,522,755 Loans: Commercial 11,063,686 10,756,312 Consumer 10,010,289 9,684,319 Residential mortgages 5,074,684 4,109,216 Total loans 26,148,659 24,549,847 Less allowance for loan losses (327,894) (322,684) Total loans, net 25,820,765 24,227,163 Premises and equipment, net 273,278 273,931 Accrued interest receivable 190,714 175,644 Goodwill 1,027,292 1,027,292 Core deposit intangible 268,759 287,293 Bank owned life insurance 801,535 792,607 Other assets 1,553,713 1,776,910 Total assets $43,505,329 $41,055,292 Liabilities and Stockholders' Equity Liabilities: Deposits and other customer related accounts: Core and other customer related accounts $21,334,106 $21,232,550 Time deposits 6,009,902 6,282,630 Total 27,344,008 27,515,180 Borrowings and other **debt obligations** 12,197,603 9,570,356 Other liabilities 501,176 599,032 Total liabilities 40,042,787 37,684,568 Minority interests 202,136 201,757 Stockholders' equity: Common Stock 1,892,126 1,872,953 Warrants and stock options 13,944 13,230 Unallocated ESOP shares (26,078) (28,465) Treasury stock (21,927) (22,501) Accumulated other comprehensive income/(loss) (52,924) (16,345) Retained earnings 1,455,265 1,350,095 Total stockholders' equity 3,260,406 3,168,967 Total liabilities and stockholders' equity $43,505,329 $41,055,292 Sovereign Bancorp, Inc. and Subsidiaries CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited) Quarter Ended Sept. 30 June 30 Mar. 31 Dec. 31 Sept. 30 2004 2004 2004 2003 2003 (dollars in thousands, except per share data) Interest and dividend income: Interest on interest- earning deposits $1,505 $980 $528 $385 $539 Interest on investment securities Available for sale 124,803 136,497 137,226 144,787 132,211 Held to maturity 46,470 31,879 28,819 5,142 5,958 Interest on loans 412,771 345,288 333,190 324,990 325,062 Total interest and dividend income 585,549 514,644 499,763 475,304 463,770 Interest expense: Deposits and related customer accounts 83,160 63,142 65,012 68,647 73,488 Borrowings 139,439 119,463 111,935 98,178 102,990 Total interest expense 222,599 182,605 176,947 166,825 176,478 Net interest income 362,950 332,039 322,816 308,479 287,292 Provision for loan losses 25,000 32,000 43,000 40,000 36,600 Net interest income after provision for loan losses 337,950 300,039 279,816 268,479 250,692 Non-interest income: Consumer banking fees 62,771 58,072 53,985 53,778 53,531 Commercial banking fees 31,757 30,552 28,685 28,766 27,197 Mortgage banking revenue (1) (4,080) 16,436 5,427 15,725 17,458 Capital markets revenue 3,409 5,099 4,887 4,814 5,389 Bank owned life insurance income 9,922 9,588 9,626 10,810 12,080 Other 4,498 4,499 6,444 7,262 3,861 Total fees and other income before security gains 108,277 124,246 109,054 121,155 119,516 Net gain on securities 20,247 829 17,881 10,232 18,848 Total non- interest income 128,524 125,075 126,935 131,387 138,364 Non-interest expense: General and administrative Compensation and benefits 114,871 105,224 104,080 98,314 97,788 Occupancy and equipment 54,976 52,097 54,379 53,437 52,838 Technology expense 18,935 19,333 17,605 19,145 18,652 Outside services 14,332 12,746 12,336 14,148 12,192 Marketing expense 11,983 10,751 10,700 8,385 9,218 Other administrative expenses 22,583 24,433 24,046 24,201 20,132 Total general and administrative 237,680 224,584 223,146 217,630 210,820 Other expenses: Amortization of core deposit intangibles 19,836 17,576 17,553 17,823 18,246 Trust preferred securities and other minority interest expense 5,502 5,438 5,436 5,439 5,434 Equity method investments (2) 10,257 7,327 2,012 4,159 2,966 Loss/(gain) on debt extinguishment 65,546 (2,285) - - 857 Merger-related and integration charges 27,941 - 23,587 - - Total other expenses 129,082 28,056 48,588 27,421 27,503 Total non- interest expense 366,762 252,640 271,734 245,051 238,323 Income before income taxes 99,712 172,474 135,017 154,815 150,733 Income tax expense 17,170 41,120 32,790 42,228 41,500 Net income $82,542 $131,354 $102,227 $112,587 $109,233 Diluted earnings per share $0.24 $0.42 $0.33 $0.38 $0.37 Operating earnings per share (3) $0.42 $0.42 $0.40 $0.38 $0.37 Weighted average shares: Basic 335,603 306,087 300,720 292,540 292,169 Diluted 341,700 311,689 306,678 298,508 297,151 (1) Mortgage

banking activity is summarized below: Gains on sale of mortgage loans and mortgage backed securities 4,090 2,808 16,469 9,457 19,080 Net gains/(loss) recorded under SFAS 133 (112) (1,878) 81 7,895 (14,112) Mortgage servicing fees, net of mortgage servicing rights amortization 1,343 (1,628) 137 (479) (5,760) Mortgage servicing right (impairments)/ recoveries (9,401) 17,134 (11,260) (1,148) 18,250 Total mortgage banking revenues (4,080) 16,436 5,427 15,725 17,458 Sovereign Bancorp, Inc. and Subsidiaries CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited) Year to Date Sept. 30 Sept. 30 2004 2003 (dollars in thousands, except per share data) Interest and dividend income: Interest on interest-earning deposits $3,013 $1,756 Interest on investment securities Available for sale 398,526 439,910 Held to maturity 107,168 21,981 Interest on loans 1,091,249 990,800 Total interest and dividend income 1,599,956 1,454,447 Interest expense: Deposits and related customer accounts 211,314 252,042 Borrowings 370,837 305,256 Total interest expense 582,151 557,298 Net interest income 1,017,805 897,149 Provision for loan losses 100,000 121,957 Net interest income after provision for loan losses 917,805 775,192 Non-interest income: Consumer banking fees 174,828 155,041 Commercial banking fees 90,994 79,207 Mortgage banking revenue (1) 17,783 34,293 Capital markets revenue 13,395 22,200 Bank owned life insurance income 29,136 32,528 Other 15,441 11,095 Total fees and other income before **security** gains 341,577 334,364 Net gain on securities 38,957 55,825 Total non-**interest** income 380,534 390,189 Non-interest expense: General and administrative Compensation and benefits 324,175 290,436 Occupancy and equipment 161,452 157,324 Technology expense 55,873 53,887 Outside services 39,414 39,288 Marketing expense 33,434 30,439 Other administrative expenses 71,062 63,361 Total general and administrative 685,410 634,735 Other expenses: Amortization of core deposit intangibles 54,965 56,012 Trust preferred securities and other minority interest expense 16,376 37,374 Equity method investments (2) 19,596 7,338 Loss/(gain) on debt extinguishment 63,261 29,838 Merger-related and integration charges 51,528 - Total other expenses 205,726 130,562 Total non-interest expense 891,136 765,297 Income before income taxes 407,203 400,084 Income tax expense 91,080 110,820 Net income $316,123 $289,264 Diluted earnings per share $0.99 $1.01 Operating earnings per share (3) $1.24 $1.07 Weighted average shares: Basic 314,365 272,114 Diluted 320,251 287,693 (1) Mortgage banking activity is summarized below: Gains on sale of mortgage loans and mortgage backed securities 23,367 51,767 Net gains/(loss) recorded under SFAS 133 (1,909) (6,186) Mortgage servicing fees, net of mortgage servicing rights amortization (148) (11,641) Mortgage servicing right (impairments)/recoveries (3,527) 353 Total mortgage banking revenues 17,783 34,293 (2) During the second quarter of 2004, Sovereign made a $60 million investment in a synthetic fuel partnership which is accounted for as an equity method investment. As a result of the increasing significance of our equity method investment portfolios, Sovereign reclassified the income statement effects of these items to other expenses. (3) See reconciliation on Page I. Sovereign Bancorp, Inc. and Subsidiaries AVERAGE BALANCE, INTEREST AND YIELD/RATE ANALYSIS (unaudited) Quarter Ended September 30, 2004 Yield/ (dollars in thousands) Average Balance Interest (1) Rate Earning assets: Investment securities $15,045,842 $183,007 4.86% Loans: Commercial 13,006,393 162,723 4.91% Consumer 12,919,725 165,502 5.10% Residential mortgages 6,675,476 86,906 5.21% Total loans 32,601,594 415,131 5.05% Allowance for loan losses (395,427) Total earning assets 47,252,009 $598,138 5.03% Other assets 6,223,444 Total assets $53,475,453 Funding liabilities: Deposits and other customer related accounts: Core and other customer related accounts $24,753,740 $47,349 0.76% Time deposits 6,985,446 35,811 2.04% Total 31,739,186 83,160 1.04% Borrowings: Federal Home Loan Bank advances 9,759,462 87,986 3.54% Fed funds and repurchase agreements 2,797,876 16,206 2.31% Other borrowings 3,921,692 35,247 3.56% Total borrowings 16,479,030 139,438 3.34% Total funding liabilities 48,218,216 $222,599 1.83% Other liabilities 713,062 Total liabilities 48,931,278

Stockholders' equity 4,544,175 Total liabilities and stockholders' equity $53,475,453 Net interest income $375,539 Interest rate spread 2.80% Net interest margin 3.17% (1) Tax equivalent basis Sovereign Bancorp, Inc. and Subsidiaries AVERAGE BALANCE, INTEREST AND YIELD/RATE ANALYSIS (unaudited) Quarter Ended June 30, 2004 Yield/ (dollars in thousands) Average Balance Interest (1) Rate Earning assets: Investment securities $14,766,721 $179,444 4.86% Loans: Commercial 12,084,881 138,736 4.55% Consumer 11,302,412 140,510 5.00% Residential mortgages 4,854,811 67,649 5.57% Total loans 28,242,104 346,895 4.90% Allowance for loan losses (355,125) Total earning assets 42,653,700 $526,339 4.93% Other assets 5,357,589 Total assets $48,011,289 Funding liabilities: Deposits and other customer related accounts: Core and other customer related accounts $22,101,334 $32,382 0.59% Time deposits 6,070,703 30,760 2.04% Total 28,172,037 63,142 0.90% Borrowings: Federal Home Loan Bank advances 8,271,726 79,227 3.81% Fed funds and repurchase agreements 3,148,479 7,529 0.94% Other borrowings 3,868,466 32,707 3.36% Total borrowings 15,288,671 119,463 3.10% Total funding liabilities 43,460,708 $182,605 1.68% Other liabilities 671,178 Total liabilities 44,131,886 Stockholders' equity 3,879,403 Total liabilities and stockholders' equity $48,011,289 Net interest income $343,734 Interest rate spread 2.86% Net interest margin 3.22% (1) Tax equivalent basis Sovereign Bancorp, Inc. and Subsidiaries AVERAGE BALANCE, INTEREST AND YIELD/RATE ANALYSIS (unaudited) Quarter Ended September 30, 2003 Yield/ (dollars in thousands) Average Balance Interest (1) Rate Earning assets: Investment securities $11,280,351 $145,505 5.16% Loans: Commercial 10,761,231 130,897 4.77% Consumer 9,340,289 130,403 5. 54% Residential mortgages 4,335,326 64,616 5.96% Total loans 24,436,846 325,916 5.28% Allowance for loan losses (323,743) Total earning assets 35,393,454 $471,421 5.29% Other assets 5,773,003 Total assets $41,166,457 Funding liabilities: Deposits and other customer related accounts: Core and other customer related accounts $21,093,786 $31,967 0.60% Time deposits 6,430,966 41,521 2.56% Total 27,524,752 73,488 1.06% Borrowings: Federal Home Loan Bank advances 5,968,148 73,111 4.83% Fed funds and repurchase agreements 1,303,393 3,328 1.01% Other borrowings 2,291,656 26,551 4.58% Total borrowings 9,563,197 102,990 4.25% Total funding liabilities 37,087,949 $176,478 1.88% Other liabilities 988,561 Total liabilities 38,076,510 Stockholders' equity 3,089,947 Total liabilities and stockholders' equity $41,166,457 Net interest income $294,943 Interest rate spread 2.85% Net interest margin 3.32% (1) Tax equivalent basis Sovereign Bancorp, Inc. and Subsidiaries AVERAGE BALANCE, INTEREST AND YIELD/RATE ANALYSIS (unaudited) Year to Date September 30, 2004 Average Yield/ (dollars in thousands) Balance Interest (1) Rate Earning assets: Investment securities $14,645,912 538,827 4.90% Loans: Commercial 12,171,171 433,788 4.69% Consumer 11,569,780 441,722 5.10% Residential mortgages 5,549,520 221,298 5.32% Total loans 29,290,471 1,096,808 4.97% Allowance for loan losses (364,857) Total earning assets 43,571,526 $1,635,635 4.99% Other assets 5,558,865 Total assets $49,130,391 Funding liabilities: Deposits and other customer related accounts: Core and other customer related accounts $22,741,136 $111,393 0.65% Time deposits 6,390,430 99,921 2.09% Total 29,131,566 211,314 0.97% Borrowings: Federal Home Loan Bank advances 8,701,974 245,027 3.72% Fed funds and repurchase agreements 2,833,640 31,153 1.46% Other borrowings 3,785,105 94,657 3.31% Total borrowings 15,320,719 370,837 3.20% Total funding liabilities 44,452,285 $582,151 1.74% Other liabilities 681,635 Total liabilities 45,133,920 Stockholders' equity 3,996,471 Total liabilities and stockholders' equity $49,130,391 Net interest income $1,053,484 Interest rate spread 2.85% Net interest margin 3.22% (1) Tax equivalent basis Sovereign Bancorp, Inc. and Subsidiaries AVERAGE BALANCE, INTEREST AND YIELD/RATE ANALYSIS (unaudited) Year to Date September 30, 2003 Average Yield/ (dollars in thousands) Balance Interest (1) Rate Earning assets: Investment securities $11,894,103 $478,552 5.36% Loans: Commercial 10,531,400 403,546 5.06% Consumer 8,970,627 390,332 5.82% Residential mortgages 4,451,050 200,034 5.99% Total loans 23,953,077 993,912 5.52%

Allowance for loan losses (312,308) Total earning assets 35,534,872 $1,472,464 5.51% Other assets 5,453,491 Total assets $40,988,363 Funding liabilities: Deposits and other customer related accounts: Core and other customer related accounts $20,217,404 $116,955 0.77% Time deposits 6,640,323 135,087 2.72% Total 26,857,727 252,042 1.25% Borrowings: Federal Home Loan Bank advances 5,865,820 224,937 5.08% Fed funds and repurchase agreements 1,972,641 3,881 0.25% Other borrowings 2,086,034 76,438 4.86% Total borrowings 9,924,495 305,256 4.07% Total funding liabilities 36,782,222 $557,298 2.01% Other liabilities 1,268,257 Total liabilities 38,050,479 Stockholders' equity 2,937,884 Total liabilities and stockholders' equity $40,988,363 Net interest income $915,166 Interest rate spread 2.97% Net interest margin 3.43% (1) Tax equivalent basis Sovereign Bancorp, Inc. and Subsidiaries SUPPLEMENTAL INFORMATION (unaudited) NON-PERFORMING ASSETS Sept. 30 June 30 Mar. 31 Dec. 31 Sept. 30 (dollars in thousands) 2004 2004 2004 2003 2003 Non-accrual loans: Commercial $89,061 $90,370 $113,734 $129,029 $165,317 Consumer 24,417 27,923 31,573 30,921 29,667 Residential mortgages 32,858 32,635 41,925 38,195 39,745 Total non-accrual loans 146,336 150,928 187,232 198,145 234,729 Restructured loans 1,205 1,262 1,378 1,235 1,335 Total non-performing loans 147,541 152,190 188,610 199,380 236,064 Real estate owned, net 16,397 19,609 18,349 17,016 17,556 Other repossessed assets 4,824 4,268 5,006 4,051 4,082 Total non- performing assets $168,762 $176,067 $211,965 $220,447 $257,702 Non-performing loans as a percentage of total loans 0.42% 0.52% 0.68% 0.76% 0.96% Non-performing assets as a percentage of total assets 0.30% 0.36% 0.45% 0.51% 0.63% Non-performing assets as a percentage of total loans, real estate owned and repossessed assets 0.48% 0.60% 0.76% 0.84% 1.05% Allowance for loan losses as a percentage of non-performing loans 276% 232% 186% 164% 137% NET LOAN CHARGE-OFFS Sept. 30 June 30 Mar. 31 Dec. 31 Sept. 30 Quarters ended (in thousands) 2004 2004 2004 2003 2003 Commercial real estate $(1,064) $6,117 $3,558 $98 $2,308 Commercial and industrial and other 10,823 14,502 19,767 25,755 22,151 Total Commercial 9,759 20,619 23,325 25,853 24,459 Auto loans 7,615 6,418 7,408 5,521 5,038 Home equity loans and other 2,770 3,268 3,605 3,277 2,964 Total Consumer 10,385 9,686 11,013 8,798 8,002 Residential mortgages 326 65 209 138 992 Total $20,470 $30,370 $34,547 $34,789 $33,453 DEPOSIT AND OTHER CUSTOMER RELATED ACCOUNT COMPOSITION - End of period Sept. 30 June 30 Mar. 31 Quarters ended (in thousands) 2004 2004 2004 Demand deposit accounts $5,072,090 $4,698,610 $4,481,546 NOW accounts 7,748,012 6,554,831 6,248,412 Customer repurchase agreements 848,890 810,062 789,524 Savings accounts 3,667,116 3,303,890 3,317,836 Money market accounts 8,407,688 7,456,917 7,102,117 Certificates of deposits 7,357,882 6,176,310 6,178,871 Total $33,101,678 $29,000,620 $28,118,306 DEPOSIT AND OTHER CUSTOMER RELATED ACCOUNT COMPOSITION - End of period Dec. 31 Sept. 30 Quarters ended (in thousands) 2003 2003 Demand deposit accounts $4,306,376 $4,292,621 NOW accounts 6,068,163 6,294,730 Customer repurchase agreements 1,017,544 902,522 Savings accounts 3,098,892 3,166,319 Money market accounts 6,843,131 6,576,358 Certificates of deposits 6,009,902 6,282,630 Total $27,344,008 $27,515,180 LOAN COMPOSITION - End of period Sept. 30 June 30 Mar. 31 Quarters ended (in thousands) 2004 2004 2004 Commercial real estate $5,800,536 $5,050,915 $4,993,700 Commercial industrial loans 7,645,199 7,200,541 6,926,275 Total commercial loans 13,445,735 12,251,456 11,919,975 Home equity loans 8,988,139 7,790,049 6,971,401 Auto loans 4,340,487 3,631,153 3,621,169 Other 528,366 564,905 419,533 Total consumer loans 13,856,992 11,986,107 11,012,103 Total residential loans 7,958,974 4,892,305 4,806,494 Total loans $35,261,701 $29,129,868 $27,738,572 LOAN COMPOSITION - End of period Dec. 31 Sept. 30 Quarters ended (in thousands) 2003 2003 Commercial real estate $4,702,046 $4,660,138 Commercial industrial loans 6,361,640 6,096,174 Total commercial loans 11,063,686 10,756,312 Home equity loans 6,457,682 6,102,455 Auto loans 3,240,383 3,261,150 Other 312,224 320,714 Total consumer loans 10,010,289 9,684,319 Total residential loans 5,074,684 4,109,216 Total loans $26,148,659 $24,549,847 Sovereign Bancorp,

Inc. and Subsidiaries SUPPLEMENTAL INFORMATION (unaudited) DEPOSIT AND OTHER CUSTOMER RELATED ACCOUNT COMPOSITION - Average Sept. 30 June 30 Mar. 31 Quarters ended (in thousands) 2004 2004 2004 Demand deposit accounts $4,936,996 $4,506,601 $4,239,684 NOW accounts 7,117,978 6,313,501 5,990,184 Customer repurchase agreements 821,182 784,850 880,544 Savings accounts 3,621,567 3,328,743 3,217,946 Money market accounts 8,256,017 7,167,639 7,017,860 Certificates of deposits 6,985,446 6,070,703 6,108,153 Total $31,739,186 $28,172,037 $27,454,371 Sovereign Bancorp, Inc. and Subsidiaries SUPPLEMENTAL INFORMATION (unaudited) DEPOSIT AND OTHER CUSTOMER RELATED ACCOUNT COMPOSITION - Average Dec. 31 Sept. 30 Quarters ended (in thousands) 2003 2003 Demand deposit accounts $4,197,814 $4,186,582 NOW accounts 6,135,210 6,253,423 Customer repurchase agreements 963,885 970,330 Savings accounts 3,138,766 3,180,188 Money market accounts 6,744,627 6,503,263 Certificates of deposits 6,138,121 6,430,966 Total $27,318,423 $27,524,752 LOAN COMPOSITION - Average Sept. 30 June 30 Mar. 31 Quarters ended (in thousands) 2004 2004 2004 Commercial real estate $5,621,144 $5,014,765 $4,869,200 Commercial industrial loans 6,534,378 6,214,663 5,669,558 Other 850,871 855,453 874,302 Total commercial loans 13,006,393 12,084,881 11,413,060 Home equity loans 8,177,146 7,206,082 6,666,343 Auto loans 4,198,175 3,636,061 3,457,105 Other 544,404 460,269 348,921 Total consumer loans 12,919,725 11,302,412 10,472,369 Total residential loans 6,675,476 4,854,811 5,105,900 Total loans $32,601,594 $28,242,104 $26,991,329 LOAN COMPOSITION - Average Dec. 31 Sept. 30 Quarters ended (in thousands) 2003 2003 Commercial real estate $4,662,734 $4,610,919 Commercial industrial loans 5,336,532 5,285,571 Other 881,626 864,741 Total commercial loans 10,880,892 10,761,231 Home equity loans 6,241,296 5,824,058 Auto loans 3,248,915 3,203,014 Other 319,592 313,217 Total consumer loans 9,809,803 9,340,289 Total residential loans 4,726,609 4,335,326 Total loans $25,417,304 $24,436,846 Sovereign Bancorp, Inc. and Subsidiaries RECONCILIATION OF CASH AND OPERATING EARNINGS TO REPORTED EARNINGS (unaudited)

Operating earnings for 2004 exclude the after tax effects of loan loss provision and merger expenses related to the First Essex and Seacoast acquisitions and the after-tax effects of the loss on our debt extinguishment of holding company notes in September 2004. The forward-looking operating earnings guidance for 2004 excludes the anticipated impact of EITF 04-8 which will be effective in the fourth quarter of 2004. Operating earnings for 2003 excludes the after tax effects of the loss on our debt extinguishment of holding company notes that occurred in March 2003. Cash earnings are operating earnings excluding the after-tax effects of non-cash charges for amortization of intangible assets and stock based compensation. (dollars in thousands, except per share data - all amounts are after tax) Quarter Ended Total dollars Sept. 30 Jun. 30 Sept. 30 2004 2004 2003 Net income as reported $82,542 $131,354 $109,233 Business acquisitions: Merger related and integration costs 18,162 - - Provision for loan loss - - - Adoption of EITF 04-8 (1) - - - Loss on debt extinguishment 42,605 - - Operating earnings 143,309 131,354 109,233 Amortization of intangibles 14,578 12,047 12,387 Stock based compensation (2) 3,671 3,761 2,795 Cash earnings $161,558 $147,162 $124,415 Weighted average diluted shares 341,700 311,689 297,151 Sovereign Bancorp, Inc. and Subsidiaries RECONCILIATION OF CASH AND OPERATING EARNINGS TO REPORTED EARNINGS (unaudited) (dollars in thousands, except per share data - all amounts are after tax) Quarter Ended Per share Sept. 30 Jun. 30 Sept. 30 2004 2004 2003 Net income as reported $0.24 $0.42 $0.37 Business acquisitions: Merger related and integration costs 0.05 - - Provision for loan loss - - - Adoption of EITF 04-8 (1) - - - Loss on debt extinguishment 0.13 - - Operating earnings 0.42 0.42 0.37 Amortization of intangibles 0.04 0.04 0.04 Stock based compensation (2) 0.01 0.01 0.01 Cash earnings $0.47 $0.47 $0.42 Weighted average diluted shares Sovereign Bancorp, Inc. and Subsidiaries RECONCILIATION OF CASH AND OPERATING EARNINGS TO REPORTED EARNINGS (unaudited) (dollars in thousands, except per share data - all amounts are

after tax) Year to Date Total dollars Per Share Sept. Sept. Sept. 30 Sept. 30 30 30 2004 2003 2004 2003 Net income as reported $316,123 $289,264 $0.99 $1.01 Business acquisitions: Merger related and integration costs 33,493 - 0.11 - Provision for loan loss 3,900 - 0.01 - Adoption of EITF 04-8 (1) - - - - Loss on debt extinguishment 42,605 18,838 0.13 0.07 Operating earnings 396,121 308,102 1.24 1.07 Amortization of intangibles 38,624 37,989 0.12 0.13 Stock based compensation (2) 10,900 8,265 0.03 0.03 Cash earnings $445,645 $354,356 $1.39 $1.23 Weighted average diluted shares 320,251 288,296 Sovereign Bancorp, Inc. and Subsidiaries RECONCILIATION OF CASH AND OPERATING EARNINGS TO REPORTED EARNINGS (unaudited) (dollars in thousands, except per share data - all amounts are after tax) Forward-Looking Per Share 2004 2005 Net income as reported $1.36 - $1.41 $1.84 - $1.94 Business acquisitions: Merger related and integration costs 0.11 .04 - .06 Provision for loan loss 0.01 - Adoption of EITF 04-8 (1) 0.03 - 0.04 - Loss on debt extinguishment 0.13 - Operating earnings $1.65 - $1.70 $1.90 - $2.00 Amortization of intangibles 0.16 Stock based compensation (2) 0.04 Cash earnings $1.85 - $1.90 Weighted average diluted shares (1) Effective in the fourth quarter of 2004, Sovereign will be required to adopt EITF 04-8 "Accounting Issues Related to Certain Features of Contingently Convertible Debt and the Effect on Diluted Earnings per Share". This EITF requires the potential dilution from contingently convertible debt be included in the calculation of diluted earnings per share upon the issuance of the debt. Sovereign issued $800 million of contingently convertible trust preferred equity income redeemable securities in the first quarter of 2004. Prior period earnings per share will be required to be restated as detailed below. Year to Quarter Ended Date Sept. 30 Jun. 30 Mar. 30 Sept. 30 2004 2004 2004 2004 Net income as reported: $82,542 $131,354 $102,227 $316,123 Addback : Contingently convertible trust preferred interest expense, net of tax 6,310 6,300 2,285 14,895 Adjusted net income for earnings per share purposes $88,852 $137,654 $104,512 $331,018 Weighted average diluted shares as reported 341,700 311,689 306,678 320,251 Additional dilution from contingently convertible debt 26,082 26,082 9,675 20,613 Adjusted weighted average diluted shares 367,782 337,771 316,353 340,864 Adjusted diluted earnings per share 0.24 0.41 0.33 0.97 (2) Stock based compensation encompasses arrangements with employees under which the Company's obligation will be settled by using stock rather than cash and includes expense related to stock options, restricted stock, bonus deferral plans, and ESOP expense. Sovereign Bancorp, Inc. and Subsidiaries SUPPLEMENTAL INFORMATION (unaudited) Purchase of First Essex Bancorp Inc. ("First Essex")

On February 6, 2004 Sovereign completed the purchase of First Essex and the results of its operations are included from purchase date through September 30, 2004. Sovereign issued 12.7 million shares of common stock and exchanged Sovereign stock options for existing First Essex stock options, whose combined value totaled $209.9 million and made cash payments of $208.2 million to acquire and convert all outstanding First Essex shares and stock options and pay associated fees. The preliminary **purchase** price was allocated to acquired **assets** and liabilities of First Essex based on fair value as of February 6, 2004. The company is in the process of finalizing these values and as such the allocation of the **purchase** price is subject to revision.

Assets and Liabilities Acquired from First Essex as of February 6, 2004: (dollars in millions) Assets Liabilities Investments 394.8 Deposits: Loans: Core 777.0 Commercial 710.4 Time 488.6 Consumer 435.6 Total deposits 1,265.6 Residential mortgages 52.2 Borrowings and other **debt obligations** 236.9 Total loans 1,198.2 Other liabilities 27.5 Less allowance for loan losses (14.7) Total loans, net 1,183.5 Total liabilities $1,530.0 Federal funds and cash (199.0) Premises and equipment, net 9.2 Other real estate owned 1.0 Other assets 72.7 Core deposit intangible 15.6 Goodwill 262.1 Total assets $1,739.9

In connection with the First Essex acquisition, Sovereign recorded

charges against its earnings for the three month period ended March 31, 2004 for an additional loan loss provision of $6.0 million pretax ($3.9 million net of tax) to conform First Essex's allowance for loan losses to Sovereign's reserve policies and for merger related expenses of $23.6 million pretax ($15.3 million net of tax). Sovereign Bancorp, Inc. and Subsidiaries SUPPLEMENTAL INFORMATION (unaudited) Purchase of Seacoast Bancorp Inc. ("Seacoast")

On July 23, 2004, Sovereign completed the purchase of Seacoast and the results of its operations are included from purchase date through September 30, 2004. Sovereign issued 36.2 million shares of common stock and exchanged Sovereign stock options for existing Seacoast stock options, whose combined value totaled $821.7 million and made cash payments of $256.2 million to acquire and convert all outstanding Seacoast shares and stock options and pay associated fees. The preliminary **purchase** price was allocated to acquired **assets** and liabilities of Seacoast based on fair value as of July 23, 2004. The company is in the process of finalizing these values and as such the allocation of the **purchase** price is subject to revision. **Assets** and Liabilities Acquired from Seacoast as of July 23, 2004: (dollars in millions) Assets Liabilities Investments 714.9 Deposits: Loans: Core 2,451.5 Commercial 966.4 Time 1,202.9 Consumer 1,015.2 Total deposits 3,654.4 Residential mortgages 2,120.4 Borrowings and other **debt obligations** 1,158.5 Total loans 4,102.0 Other liabilities 83.9 Less allowance for loan losses (49.5) Total loans, net 4,052.5 Total liabilities $4,896.8 Cash paid, net of cash acquired (32.2) Premises and equipment, net 63.0 Other real estate owned 0.7 Other assets 25.4 Core deposit intangible 75.4 Goodwill 818.8 Total assets $5,718.5

In connection with the Seacoast acquisition, Sovereign recorded charges against its earnings for the three month period ended September 30, 2004 for merger related expenses of $27.9 million pretax ($18.2 million net of tax). Sovereign Bancorp, Inc.

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Web site: http://www.sovereignbank.com/

Company Names: Seacoast Financial Services Corp; Sovereign Bancorp Inc
Descriptors: Company News; Interim Results; Mergers & Acquisitions; Results
Province/State: Pennsylvania

109/9/2 (Item 2 from file: 20)
38152046
Fitch Rates Streeterville ABS CDO 'AAA/AA/A-'

BUSINESS WIRE
October 01, 2004
Journal Code: WBWE **Language:** English **Record Type:** FULLTEXT
Word Count: 553

Fitch Ratings assigns the following ratings to Streeterville ABS CDO, Ltd.

and Streeterville ABS CDO, Inc. (collectively referred to as the co-issuers):

-- $850,000,000 class A-1 first priority senior secured **floating-rate** delayed draw **notes** 'AAA';

-- $50,000,000 class A-2 second priority senior secured **floating-rate notes** 'AAA';

-- $30,000,000 class B-1 third priority secured **floating-rate notes** 'AA';

-- $37,000,000 class B-2 third priority secured fixed-**rate notes** 'AA';

-- $6,000,000 class C-1 mezzanine secured **floating-rate notes** 'A-';

-- $10,000,000 class C-2 mezzanine secured fixed-**rate notes** 'A-'.

The ratings of the class A-1, class A-2, class B-1, and class B-2 notes address the likelihood that investors will receive full and timely payments of interest, as per the governing documents, as well as the aggregate outstanding amount of principal by the legal final maturity date. The ratings of the class C-1 and class C-2 notes address the likelihood that investors will receive ultimate interest and deferred interest payments, as per the governing documents, as well as the aggregate outstanding amount of principal by the legal final maturity date.

The ratings are based upon the credit quality of the underlying assets and the credit enhancement provided to the capital structure through subordination and excess spread. Additionally, the ratings address the experience and capabilities of Vanderbilt Capital Advisors, LLC (Vanderbilt) as the **asset** manager.

The net proceeds from the issuance of the notes will be used to **purchase** a high grade portfolio consisting of approximately 79% of residential mortgage-backed securities (RMBS), 1% of commercial mortgage-backed securities (CMBS) and consumer asset-backed securities (ABS), and 20% of collateralized **debt obligations** (CDOs). The collateral supporting the structure will have a maximum Fitch-weighted average rating factor (WARF) of 0.85 ('AA+/AA') and was approximately $765 million, or 77% of the target portfolio amount ramped up at closing. The asset manager will have 120 days from the closing date to ramp-up to the target portfolio amount of $1 billion. The substitution period will last up to three years after deal closing.

The notes have a stated maturity of November 2040 and quarterly payments on the notes will begin on Feb. 3, 2005. This transaction includes a structural feature that diverts excess interest to pay down the notes. Starting in November 2012, excess interest will be used to pay principal on the notes on a reverse sequential basis. Upon the breach of the **interest** coverage (IC) test as outlined in the **security** agreement, excess **interest** will be used to redeem the notes sequentially. Upon the breach of the overcollateralization (OC) test as outlined in the **security** agreement, excess **interest** will be used to redeem the notes in reverse sequential order. In the event that both OC and IC tests are failing, the notes will be redeemed sequentially to cure the IC test first.

The **asset** manager, Vanderbilt, will **purchase** all investments for the portfolio on behalf of the co-issuers, which are special purpose companies incorporated under the laws of the Cayman Islands and State of Delaware, respectively. The asset manager will monitor the portfolio in accordance with specific investment restrictions as outlined in the governing documents.

For more information on this transaction, see the presale report titled 'Streeterville ABS CDO,' available on the Fitch Ratings web site at 'www.fitchratings.com'.

Fitch Ratings Sajjad Hussain, CFA, 312-606-2337 Eric Hedoin, 312-606-2360, Chicago Sandro Scenga, 212-908-0278, New York (Media Relations)

Company Names: Fitch IBCA
Descriptors: Company News; Credit Rating

109/9/3 (Item 3 from file: 20)
34165982
HSBC Holdings PLC - Final Results-HSBC USA Inc.P2

PART 2

CNF
March 01, 2004
Journal Code: WRNS **Language:** English **Record Type:** FULLTEXT
Word Count: 21626

RISK MANAGEMENT
Overview

Some degree of risk is inherent in virtually all of the Company's activities. For the principal activities undertaken by the Company, the most important types of risks are considered to be credit, market, interest rate, liquidity, operational, fiduciary and reputational. Market risk includes interest rate and trading risk, where trading risk refers broadly to all price risk reflected in mark to market positions.

The objective of the Company's risk management system is to identify and measure risks so that:

- the potential costs can be weighed against the expected rewards from taking the risks
- unexpected losses can be minimized
- appropriate disclosures can be made to all concerned parties
- adequate protections, capital and other resources can be put in place to weather all significant risks

Historically, the Company's approach to risk management has emphasized a culture of business line responsibility combined with central requirements for the diversification of customers and businesses. Extensive central requirements for controls, limits, reporting and the escalation of issues have been detailed in Company policies and procedures.

The Company recently embarked upon a multi-year program to upgrade its risk measurement methodologies and systems. The new practices and techniques involve more data, modeling, simulation and analysis. A new senior leadership structure has been introduced and includes independent risk specialists for operational and fiduciary risk, in addition to the existing risk specialists for credit and market activities, and the appointment of a Chief Risk Officer responsible for Company-wide risk management.

Risk management oversight begins with the Company's Board of Directors and its various committees, principally the Audit and Examining

Committee. Management oversight is provided by the Risk Management Committee which is chaired by the Chief Risk Officer, and which leverages itself off four principal subcommittees:

- Credit Risk Committee
- Asset and Liability Policy Committee
- Operational Risk Management Committee
- Fiduciary Risk Management Committee

Day-to-day management of credit risk is centralized under the Chief Credit Officer, and market risk principally under the Treasurer. Management of operational and fiduciary risk is decentralized and is the responsibility of each business and support unit. However, all risk areas have independent risk specialists setting standards, developing the new risk measurement methodologies, operating central risk databases, and conducting reviews and analyses. The Chief Risk Officer provides day-to-day oversight of these activities and works closely with Compliance and Audit.

Future Transactions With Household

Pending regulatory and other approvals, the Company is in the process of pursuing the transfer of certain assets from Household, including additional residential mortgage assests and interest in credit card receivables. These transactions potentially could have a significant impact on the economic and regulatory capital, credit risk, interest rate management, and liquidity management practices of the Company.

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Economic and Regulatory Capital

A critical aspect of risk management is to define how much capital is needed to support losses that could emanate from the risks that underlie the Company's businesses. This calculation is referred to as economic capital. Economic capital is an estimate of how much capital is needed by the Company, as opposed to the amount of capital actually held by the Company as a result of capital issuance, earnings retention and provisioning. In early 2004, the Company will begin to calculate economic capital from statistical analyses of possible losses related to credit, market, interest rate and operational risk. Confidence levels have been established: the Company targets having economic capital sufficient to cover losses over a one year time horizon 99.95% of the time. This is consistent with the maintenance of the Bank's "AA" rating, as "AA" rated credits have historically defaulted at a rate of about .05% per year. The one year time horizon is also consistent with traditional planning and budgeting time horizons. Quantification of possible losses related to other risks, such as fiduciary and reputational risk, are broadly covered under the credit, market and operational risk quantifications.

The new data collection and quantitative methodologies the Company is putting in place for calculating economic capital are consistent with the requirements for the proposed advanced approaches for determining regulatory capital under the New Basel Capital Accord, being developed by the Basel Committee on Banking Supervision (Basel II). The advanced approaches include the Internal Ratings Based-Advanced approach for calculating credit risk capital requirements and the Advanced Measurement Approaches for calculating operational risk capital requirements. The Company is not required to adopt the advanced approaches by its primary regulator, the Federal Reserve, but is intending to do so voluntarily. Implementation of the advanced approaches remains subject to the finalization of the Accord by the Basel Committee, and its adoption by U.S. regulators.

Credit Risk Management

Credit risk is the potential that a borrower or counterparty will fail to perform an obligation. Potential loss includes loss in the event of default, or the change in the value of a credit obligation because of changes in the view of its possible **default**.

Credit risk exists widely in the Company: for example, in loan portfolios and **investment** portfolios; in unfunded commitments

such as lines of credit that customers can draw upon; in treasury instruments, such as interest rate swaps which, if more valuable today than when originally contracted, may represent an exposure to the counterparty to the contract. While credit risk exists widely within the Company, the fact of diversification, particularly among various commercial and consumer portfolios, helps the Company to lessen risk exposure.

Credit risk exposure is controlled by the Company through various lending caps, prohibitions, and guidances. The Company monitors and limits its exposure to individual counterparties and to the combined exposure of related counterparties. In addition, selected industry portfolios, such as real estate, telecommunications, aviation, and shipping, are subject to caps which are established by the Chief Credit Officer and reviewed where appropriate by management and board committees. Counterparty credit exposure related to derivatives activities is also managed under approved limits. Since the exposure related to derivatives is variable and uncertain, the Company uses internal risk management methodologies to calculate the 95% worst case potential future exposure for each customer. These methodologies take into consideration cross-product close-out netting, collateral received from customers under Collateral Support Annexes (CSA), termination clauses, and off-setting positions within the portfolio among other things.

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In addition to controlling credit risk exposure the credit approval, policy and monitoring functions are centrally managed under the control of the Chief Credit Officer, and are subject to certain limits and approvals by the Company's parent holding company, HSBC. While the Chief Credit Officer is responsible for the design and

management of the credit function, the Credit Risk Management Committee is responsible for strategic and collection oversight of the scope of the risk being taken, the adequacy of the tools used to measure it, and the adequacy of reporting.

Under the multi-year program to enhance risk management, the Company introduced late in 2003 a new 22 level credit risk grading system to replace its previous 7 level system. The new system allows the Company to measure customer risk on a more granular scale and with quantitative measures calibrated to the performance of Standard and Poor's Long-Term Debt Ratings over a twenty year period.

The new system is two-dimensional with a customer rating measuring probability of default (frequency) and a transaction rating measuring the probable loss in the event of default (severity). A suite of models, tools and templates supports the estimation of the probability of default. This suite has been developed using a combination of internal and external resources and data and closely follows what has been determined to be best practice in the industry. To estimate the probable loss in the event of default, the Company is building a significant database of historic credit losses, again, from both internal and external sources, and has implemented other tools and models to support this effort.

Expected losses and hence desired credit reserves will be calculated based on probability of default (frequency) and loss given default (severity) beginning in 2004. While this analysis will be done for individual corporate and commercial transactions, for retail and small business portfolios it will be done using pools of similar credits within various customer segments. Correlations among credits in the same portfolios will also be calculated to indicate whether credit risks are more tied to a creditor's own fundamentals as opposed to industry fundamentals.

Also in 2003, the Company started pilot calculations of economic capital related to credit risk. A simulation model is used to determine the amount of possible losses, beyond expected losses, that the Company must be prepared to support with capital. The Company intends to continue to refine its calculation of economic capital related to credit risk and

begin to integrate the new credit risk modeling tools into the credit decision making process as appropriate.

The credit profile of the Company is subject to changes due to business strategies and conditions as well as credit quality. The following table indicates certain sensitivities at December 31, 2003.

Impact

Element of Change Element Affected From To --------- -------- in millions 25% of pass grade credits drop one grade: Criticized assets $ 1,428 $ 4,066 Allowance for credit losses 399 447 Reserve for off-balance sheet items 44 129

All pass grade credits drop one grade: Criticized assets 1,428 11,980 Allowance for credit losses 399 591 Reserve for off-balance sheet items 44 384

10% lower unallocated reserve for credit losses: Allowance for credit losses 399 392

50

Asset/Liability Management

Asset and liability management includes management of liquidity and market risk. Liquidity risk is the potential that an institution will be unable to meet its obligations as they become due or fund its customers because of inadequate cash flow or the inability to liquidate assets or obtain funding itself. Market risk includes both interest rate and trading risk. Interest rate risk is the potential impairment of net interest income due to mismatched pricing between assets and liabilities and off-balance sheet instruments. Market risk is the potential for losses in daily mark to market positions (mostly trading) due to adverse movements in money,

foreign exchange, equity or other markets. In managing these risks, the Company seeks to protect both its income stream and the value of its assets.

The Company has substantial, but historically well controlled, interest rate risk in large part as a result of its large portfolio of residential mortgages and mortgage backed securities, which consumers can prepay without penalty, and to a lesser extent the result of its large base of demand and savings deposits. These deposits can be withdrawn by consumers at will, but historically they have been a stable source of funds. Market risk exists principally in treasury businesses and to a lesser extent in the residential mortgage business where mortgage servicing rights and the pipeline of forward mortgage sales are hedged. The Company has little foreign exchange exposure from investments in overseas operations, which are limited in scope, and total equity investments, excluding stock owned in the Federal Reserve and New York Federal Home Loan Bank, which are less than 2% of total available for sale securities.

The management of liquidity, interest rate and most market risk is centralized in treasury. Market risk related to residential mortgages is primarily managed by the mortgage business. In all cases, the valuation of positions and tracking of positions against limits is handled independently by the Company's finance units. Oversight of all liquidity and market risks is provided by the Asset and Liability Policy Committee (ALCO), which indicates

the limits of acceptable risk, the adequacy of the tools used to measure it, and the adequacy of reporting. ALCO also conducts contingency planning in regards to liquidity.

Liquidity Management

In providing liquidity, the Company focuses on five elements:

- customer generated deposits
- diverse sources of funds
- maximum collateral utilizing investment securities and residential mortgages, most of which are pledgeable at the New York Federal Home Loan Bank or Federal Reserve
- strong credit ratings

- positive cash flow, even in a crisis

In carrying out this responsibility, ALCO projects cash flow requirements and determines the optimal level of liquid assets and available funding sources to have at the Company's disposal, with consideration given to anticipated deposit and balance sheet growth, contingent liabilities, and the ability to access short-term wholesale funding markets. In addition, the Committee monitors deposit and funding concentrations in terms of overall mix and to avoid undue reliance on individual funding sources and large deposit relationships. It also maintains a liquidity management contingency plan, which identifies certain potential early indicators of liquidity problems, and actions, which can be taken both initially and in the event of a liquidity crisis, to minimize the long-term impact on the Company's business and customer relationships.

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Deposit accounts from a diverse mix of "core" retail, commercial and public sources represent a significant, cost-effective source of liquidity under normal operating conditions. The Company's ability to regularly attract wholesale funds at a competitive cost is enhanced by strong ratings from the major credit ratings agencies. At December 31, 2003, the Company and its principal operating subsidiary, HSBC Bank USA, maintained the following long and short-term debt ratings.

Short-Term Debt Long-Term Debt

Moody's S&P Fitch Moody's S&P Fitch

HSBC USA Inc. P-1 A-1 F1+ A1 A+ AA- HSBC Bank USA P-1 A-1+ F1+ Aa3 AA- AA-

The Company's shelf registration statement filed with the United States Securities and Exchange Commission (SEC) has $825 million available under which it may issue debt and equity securities and has ready access to the capital markets for long-term funding through the issuance of registered debt. In addition, the Company has an unused $500 million line of credit with HSBC Bank plc and, as a member of the New York Federal Home Loan Bank, has a potential secured borrowing facility in excess of $5 billion. Off-balance sheet special purpose vehicles or other off-balance sheet mechanisms are not utilized as a source of liquidity or funding.

Assets, principally consisting of a portfolio of highly rated investment securities in excess of $18 billion, approximately $7 billion of which, based on anticipated cash flows, is scheduled to mature within the next twelve months, a liquid trading portfolio of approximately $15 billion, and residential mortgages are a primary source of liquidity to the extent that they can be sold or used as collateral for borrowing. The economics and long-term business impact of obtaining liquidity from assets must be weighed against the economics of obtaining liquidity from liabilities, along with consideration given to the associated capital ramifications of these two alternatives. Currently, assets would be used to supplement liquidity derived from liabilities only in a crisis scenario.

It is the policy of the Bank to maintain both primary and secondary collateral in order to ensure precautionary borrowing availability from the Federal Reserve. Primary collateral is that which is physically maintained at the Federal Reserve, and serves as a safety net against any unexpected funding shortfalls that may occur. Secondary collateral is collateral that is acceptable to the Federal Reserve, but is not maintained there. If unutilized borrowing capacity were to be low, secondary collateral would be identified and maintained as necessary.

The Company projects, as part of normal ongoing contingency planning, that in the event of a severe liquidity problem there would be sources of cash exceeding projected uses of cash by more than $9 billion, assuming that the Company would not have access to the wholesale funds market. In addition, the Company maintains residential mortgages and other eligible collateral at the Federal Reserve that could provide additional liquidity if needed.

On December 31, 2003, approximately $2.8 billion of domestic residential mortgage loan **assets** were **purchased** from Household. It is anticipated that an additional $1.0 billion of similar receivables will be purchased from Household during the first quarter of 2004. During the remainder of 2004, the Company anticipates that approximately $3.0 billion of additional new residential mortgage loans underwritten by Household will be recorded by the Company. Subject to regulatory and other approvals, the Company anticipates the purchase of approximately $14 billion of credit card receivables from Household during 2004. As part of the same purchase transaction, residual interest in approximately $14 billion of securitized credit card receivable pools will also be transferred from Household. Subsequent to the initial

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transfer, additional credit card receivables will be purchased from Household on a daily basis. Various methods to fund these transactions are being explored, including the issuance of long-term registered debt, the filing of an additional shelf registration statement with the SEC, and liquidation of certain investment securities. A subordinated debt issuance is planned for the second quarter. The Company's objective is to maintain a strong liquidity profile in 2004.

Interest Rate Risk Management

The Company is subject to interest rate risk associated with the repricing characteristics of its balance sheet assets and liabilities and its derivative contracts. Specifically, as interest rates change, interest earning assets reprice at intervals that do not correspond to the maturities or repricing patterns of interest bearing liabilities. This mismatch between assets and liabilities in repricing sensitivity results in shifts in net interest income as interest rates move. To help manage the risks associated with changes in interest rates, and to optimize net interest income within ranges of interest rate risk that management considers acceptable, the Company uses derivative instruments such as interest rate swaps, options, futures and forwards as hedges to modify the repricing characteristics of specific assets, liabilities, forecasted transactions or firm commitments.

The following table shows the repricing structure of assets and liabilities as of December 31, 2003. For assets and liabilities whose cash flows are subject to change due to movements in interest rates, such as the sensitivity of mortgage loans to prepayments, data is reported based on the earlier of expected repricing or maturity and reflects anticipated prepayments based on the current rate environment. The resulting "gaps" are reviewed to assess the potential sensitivity to earnings with respect to the direction, magnitude and timing of changes in market interest rates. Data shown is as of year end, and one-day figures can be distorted by temporary swings in assets or liabilities.

December 31, 2003 Within After After After Total One One But Five Ten Year Within But Years Five Within Years Ten Years ---------- in millions Commercial loans (including international) $ 15,260 $ 2,474 $ 1,016 $ 413 $ 19,163 Residential mortgages 12,253 11,637 1,742 663 26,295 Other loans 2,135 808 63 10 3,016

Total loans 29,648 14,919 2,821 1,086 48,474

Securities available for sale and securities held to maturity 8,205 5,881 2,453 2,115 18,654 Other assets 23,395 2,157 2,882 - 28,434

Total assets 61,248 22,957 8,156 3,201 95,562

Domestic deposits (1) 21,200 19,765 36 - 41,001 Other liabilities/equity 46,553 330 6,107 1,571 54,561

Total liabilities 67,753 20,095 6,143 1,571 95,562

Total balance sheet gap (6,505) 2,862 2,013 1,630 -

Effect of derivative contracts (65) 50 15 - -

Total gap position $ (6,570) $ 2,912 $ 2,028 $ 1,630 $ -

(1) Includes demand, savings and certificates of deposits. Does not include purchased or wholesale treasury deposits. The placement of administered deposits such as savings and demand for interest rate risk

purposes reflects behavioral expectations associated with these balances. Long term core balances are differentiated from more fluid balances in an effort to reflect anticipated shifts of non-core balances to other deposit products or equities over time.

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The Company does not use the static "gap" measurement of interest rate risk reflected in the table above as a primary management tool. In the course of managing interest rate risk, a combination of risk assessment techniques, including dynamic simulation modeling, gap analysis, Value at Risk (VAR) and capital at risk analyses are employed. The combination of these tools enables management to identify and assess the potential impact of interest rate movements and take appropriate action.

Certain limits and benchmarks that serve as guidelines in determining the appropriate levels of interest rate risk for the institution have been established. One such limit is expressed in terms of the Present Value of a Basis Point (PVBP), which reflects the change in value of the balance sheet for a one basis point upward movement in all interest rates. The institutional PVBP limit as of December 31, 2003 was +/-$4.0 million, which includes distinct limits associated with trading portfolio activities and financial instruments. Thus, for a one basis point upward change in interest rates, the policy dictates that the value of the balance sheet shall not change by more than +/- $4.0 million. As of December 31, 2003, the Company had a position of $(0.4) million PVBP reflecting the impact of a one basis point increase in interest rates.

The Company also monitors changes in value of the balance sheet, or capital at risk, for large movements in interest rates with an overall limit of +/- 10%, after tax, change from the base case valuation for either a 200 basis point gradual rate increase or a 100 basis point gradual rate decrease. As of December 31, 2003, for a gradual 200 basis point increase in rates, the value was projected to drop by 7% and for a 100 basis point gradual decrease in rates, value was projected to drop by 3%. The projected drop in value for a 100 basis point gradual decrease in rates is primarily related to the anticipated acceleration of prepayments for the held mortgage and mortgage backed securities portfolios in this lower rate environment. This assumes that no management actions are taken to manage exposures to the changing interest rate environment.

In addition to the above mentioned limits, ALCO particularly monitors the simulated impact of a number of interest rate scenarios, on net interest income. These scenarios include both rate shock scenarios which assume immediate market rate movements of 200 basis points, as well as rate change scenarios in which rates rise or fall by 200 basis points over a twelve month period. The individual limit for such gradual 200 basis point movements is currently +/- 10%, pretax, of base case earnings over a twelve month period. Simulations are also performed for other relevant interest rate scenarios including immediate rate movements and changes in shape of the yield curve, or in competitive pricing policies. Net interest income under the various scenarios is reviewed over a twelve month period, as well as over a three year period. The simulations capture the effects of the timing of the repricing of all assets and liabilities, including derivative instruments such as interest rate swaps, futures and option contracts. Additionally, the simulations incorporate any behavioral aspects such as prepayment sensitivity under various scenarios.

For purposes of simulation modeling, base case earnings reflect the existing balance sheet composition, with balances generally maintained at current levels by the anticipated reinvestment of expected runoff. These balance sheet levels will, however, factor in specific known or likely changes, including material increases, decreases or anticipated shifts in balances due to management actions. Current rates and spreads are then applied to produce base case earnings estimates on both a twelve month and three year time horizon. Rate shocks are then modeled and compared to base

earnings (earnings at risk), and include behavioral assumptions as dictated by specific scenarios relating to such factors as prepayment sensitivity and the tendency of balances to shift among various products in different rate environments. This assumes that no management actions are taken to manage exposures to the changing environment being simulated.

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Utilizing these modeling techniques, a gradual 200 basis point parallel rise or fall in the yield curve on January 1, 2004 would cause projected net interest income for the next twelve months to decrease by $61 million (-2%) and to increase by $134 million (+5%) respectively. These changes are well within the Company's +/- 10% limit. An immediate 100 basis point parallel rise or fall in the yield curve on January 1, 2004, would cause projected net interest income for the next twelve months to decrease by $92 million and $41 million respectively. An immediate 200 basis point parallel rise or fall would decrease projected net interest income for the next twelve months by $227 million and $205 million respectively. In addition, simulations are performed to analyze the impact associated with various twists and shapes of the yield curve. If the yield curve were to flatten significantly (i.e. long end of the yield curve down) over the next twelve months, the projected margin could shrink by approximately 5% to 7%, assuming no management actions.

The projections do not take into consideration possible complicating factors such as the effect of changes in interest rates on the credit quality, size and composition of the balance sheet. Therefore, although this provides a reasonable estimate of interest rate sensitivity, actual results will vary from these estimates, possibly by significant amounts.

Large movements of interest rates could directly affect some reported capital and capital ratios. The mark to market valuation of available for sale securities is credited on a tax effective basis through other comprehensive income in the statement of shareholders' equity. This valuation mark is excluded from the Company's Tier 1 and Tier 2 capital ratios (see capital ratios table on page 5), but it would be included in two important accounting based capital ratios: the tangible common equity to tangible assets and the tangible common equity to risk weighted assets. As of December 31, 2003, the Company had a sizeable available for sale securities portfolio of $14.1 billion with a mark to market of $74.2 million included in tangible common equity of $4.0 billion. An increase of 25 basis points in interest rates of all maturities would lower the mark to market by $93.0 million to a loss of $18.8 million with the following results on the tangible capital ratios.

December 31, 2003 ---------- Actual Proforma-Reflecting 25 Basis Points Lower Rates

Tangible common equity to tangible assets 4.34 % 4.28 % Tangible common equity to risk weighted assets 6.39 6.29

In addition to using the risk measures of PVBP, capital at risk analysis, and simulation, the Company also uses Value at Risk (VAR) analysis to measure interest rate risk and to calculate the economic capital required to cover potential losses due to interest risk. PVBP, capital at risk and net interest income simulation analyses all look at what will happen as a result of change or stress. PVBP shows the current sensitivity of total present value to a one basis point movement in rates. This sensitivity may change as interest rates diverge further from current rate levels due to such factors as mortgage portfolio prepayment speeds. Capital at risk also looks at the sensitivity of total present value in stress scenarios - for example, the amount of change in value for a 100 basis point drop in term interest rates. Net interest income simulation looks at the projected flow of net interest income over time, again in response to stress scenarios. VAR, related to net interest income, on the other hand, looks at a historical observation period (here it is two years) and shows, based upon that, the potential loss from unfavorable market conditions during a "given period" with a certain confidence level (99%). The Company uses a one-day "given period" or "holding period" for

setting limits and measuring results. Thus, at a 99% confidence level for 500 business days (about two calendar years) the Company is setting as its limit the fifth worse

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loss performance in the last 500 business days. For purposes of determining economic capital the Company uses a six month "given period," a conservative time to allow for adjustments of the Company's interest rate risk profile.

The predominant VAR methodology used by the Company, "historical simulation", has a number of limitations including the use of historical data as a proxy for the future, the assumption that position adjustments can be made within the holding period specified, and the use of a 99% confidence level, which does not take into account potential losses that might occur beyond that level of confidence.

Trading Activities

The trading portfolios of the Company reside primarily in the Company's Treasury and mortgage banking areas and include foreign exchange, derivatives, precious metals (gold, silver, platinum), commodities, equities, money market instruments including "repos" and securities. Trading occurs as a result of customer facilitation, proprietary position taking, and economic hedging. In this context, economic hedging may include, for example, forward contracts to sell residential mortgages and derivative contracts which, while economically viable, may not satisfy the hedge requirements of SFAS 133.

The trading portfolios of the Company have defined limits pertaining to items such as permissible investments, risk exposures, loss review, balance sheet size and product concentrations. "Loss review" refers to the maximum amount of loss that may be incurred before senior management intervention is required.

The Company relies upon VAR analysis as a basis for quantifying and managing risks associated with the Treasury trading portfolios. Such analysis is based upon the following two general principles:

(i) VAR applies to all Treasury trading positions across all risk classes including interest rate, equity, commodity, optionality and global/foreign exchange risks and

(ii) VAR is based on the concept of independent valuations, with all transactions being repriced by an independent risk management function using separate models prior to being stressed against VAR parameters.

VAR attempts to capture the potential loss resulting from unfavorable market developments within a given time horizon (typically ten days), given a certain confidence level (99%) and based on a two year observation period.

VAR calculations are performed for market risk-related activities associated with all material Treasury trading portfolios. The VAR is calculated using the historical simulation or the variance/covariance (parametric) method. Included in the trading VAR is a Monte Carlo based estimate of "issuer specific credit risk" for fixed income securities, which captures residual risk beyond the credit spread curve by rating and the interest rate curve.

A VAR report broken down by Treasury trading business and on a consolidated basis is distributed daily to management. To measure the accuracy of the VAR model output, the daily VAR is compared to the actual result from Treasury trading activities.

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The following table summarizes Treasury trading VAR of the Company.

		Full Year 2003			
in millions	December 31, 2003	Minimum	Maximum	Average	December 31, 2002
Total trading	$ 23.1	$ 15.3	$ 35.6	$ 24.5	$ 11.4
Commodities	.5	.4	5.9	2.3	2.6
Credit derivatives	3.8	.6	3.9	1.6	2.1
Equities	.8	.8	5.2	1.3	1.0
Foreign exchange	11.5	1.0	14.2	5.0	3.1
Interest rate	15.7	13.4	37.7	21.7	8.6

The following table summarizes the frequency distribution of daily

market risk-related revenues for Treasury trading activities in 2003. Market risk-related Treasury trading revenues include realized and unrealized gains (losses) related to Treasury trading activities, but excludes the related net interest income. Analysis of 2003 gain (loss) data shows that the largest daily gain was $17.0 million and the largest daily loss was $7.5 million.

Ranges of daily Treasury trading revenue earned from market risk-related activities Below $(4) to $(2) to $0 to $2 to $4 to Over in millions $(4) $(2) $ 0 $2 $4 $ 6 $ 6 ------ Number of trading days market risk-related revenue was within the stated range 3 10 49 87 62 29 10

During 2003, the Company experienced significant volatility in its trading positions relative to mortgage banking activities, particularly derivative instruments used to protect the economic value of its MSRs portfolio. The following table summarizes the frequency distribution of weekly market risk-related revenues associated with mortgage trading positions.

Ranges of mortgage trading revenue earned from market risk-related activities Below $(20) to $(10) to $0 to $10 to Over in millions $(20) $(10) $0 $10 $20 $ 20 ------ Number of trading weeks market risk-related revenue was within the stated range 5 7 19 14 5 2

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Operational Risk

Operational risk is the risk of loss arising through fraud, unauthorized activities, errors, omissions, inefficiency, systems failure or from external events. It is inherent in every business organization and covers a wide spectrum of issues.

As part of its multi-year program to upgrade its risk management framework, the Company has developed an independent Operational Risk Management discipline. Line management is responsible for managing and controlling all risks and for communicating and implementing all control standards. A corporate Operational Risk Coordinator maintains a network of business line Operational Risk Coordinators; develops quantitative tools and databases; provides training and develops awareness; and independently reviews the assessments of Operational Risks. The Operational Risk Management Committee is responsible for oversight of the risks being taken, the analytic tools used, and reporting. Results from this Committee are communicated to the Risk Management Committee and subsequently to the Audit and Examining Committee of the Board.

The management of operational risk comprises the identification, assessment, monitoring, control and mitigation of the risk, rectification of the results of risk events and compliance with local regulatory requirements. Risk assessments were completed by the majority of businesses in the Company in 2002. The balance were completed in early 2003.

HSBC Group codified its Operational Risk Management process by issuing a high level standard in May 2002. Key features within the standard have been addressed in the Company's Operational Risk Management program and include:

- Each business and support department is responsible for the identification and management of their operational risks.
- Each risk is evaluated and scored by its likelihood to occur; its potential impact on shareholder value; and by exposure - based on the effectiveness of current controls to prevent or mitigate losses. An Operational Risk automated database is used to record risk assessments and track risk mitigation action plans. The risk assessments are reviewed as business conditions change or at least annually.
- Key risk indicators are established in the automated database where appropriate, and tracked monthly.
- The database is also used to track operational losses for analysis of root causes, comparison with risk assessments and lessons learned.

Management practices include standard monthly reporting of high

risks, risk mitigation action plan exceptions, losses and key risk indicators to business line managers, executive management and the Operational Risk Management Committee. Monthly certification of internal controls includes an Operational Risk attestation. Operational Risk Management is an integral part of the new product development process and the management performance measurement process.

Internal audits, including audits by specialist teams in information technology and treasury, provide an important check on controls and test institutional compliance with the Operational Risk Management policy.

An annual review of internal controls is conducted by internal audit as part of the Company's compliance with the Federal Deposit Insurance Corporation Improvement Act (FDICIA) and its comprehensive examination and documentation of controls across the Company involving all business and support units.

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In the fall of 2003, the Company completed pilot calculations of economic capital related to operational risk using all available internal data as well as external loss data.

Business Continuity Planning

The Company is committed to the protection of employees, customers and shareholders by a quick response to all threats to the organization, whether they are of a physical or financial nature. For this purpose, the Company has established a Business Continuity Event Management (EM) process. EM provides an enterprise-wide response and communication framework for managing major business continuity events or incidents. It is designed to be flexible and is scaled to the scope and magnitude of the event or incident.

The EM process works in tandem with the Company's business continuity policy, plans and key business continuity committees to manage events. The Company's Crisis Management Committee, a 24/7 standing committee, is activated to manage the EM process in concert with senior Company management. This committee provides critical strategic and tactical management of business continuity crisis issues, risk management, communication, coordination and recovery management. The Company also has designated an Institutional Manager for Business Continuity who plays a key role on the Crisis Management Committee. All major business and support functions have a senior representative assigned to the Company's Business Continuity Planning Committee chaired by the Institutional Manager.

The Company has dedicated certain work areas as hot and warm backup sites, which serve as primary business recovery locations. The Company also has concentrations of major operations in both upstate and downstate New York. This geographic split of major operations is leveraged to provide secondary business recovery sites for many critical business and support areas of the Company.

The Company has built its own tier-4 (highest level of resiliency) data center for disaster recovery purposes. Data is mirrored synchronously to the disaster recovery site across duplicate dark fiber loops. A high level of network backup resiliency has been established. In a disaster situation, the Company is positioned to bring main systems and server applications online with predetermined timeframes.

The Company tests business continuity and disaster recovery resiliency and capability through routine contingency tests and actual events. Business continuity and disaster recovery programs have been strengthened in numerous areas as a result of these tests or actual events. There is a continuing effort to enhance the program well beyond the traditional business resumption and disaster recovery model.

In 2003, the Company determined the applicability of the Interagency Paper on "Sound Practices to Strengthen the Resiliency of the U.S. Financial System". The Company is committed to meeting or exceeding the requirements of the paper for the businesses impacted by the compliance due date.

Business continuity is a critically and strategically important objective for the Company.

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Fiduciary Risk

Fiduciary risk is the potential that we may fail to perform properly advisory services that have been agreed to be performed for fees. These risks occur in several of the Company's businesses such as private banking, investment management, investment advisory, or corporate trust. Frequently risks occur in areas regulated by Federal securities laws. Almost always they occur in areas where the Company is entrusted to handle customer business affairs with discretion or judgments. Many fiduciary risks are operational risks, such as settlement fails on a trust customer's accounts, but others are not, such as inappropriate investment allocations.

Fiduciary risk management is overseen by the Fiduciary Risk Management Committee. Day-to-day oversight and testing of controls, and the recommendation of appropriate tools, is done by an independent Fiduciary Risk Officer appointed in July 2003.

As part of its multi-year program to enhance risk measurement and management, the Company is identifying and scoring all fiduciary risk by likelihood, potential severity, and exposure; conducting self assessments of controls; and tracking of key indicators of risk. Risk indicators are warning signals if they change too much too fast (for example, levels of uninvested cash) or are too large or too high (for example, systems down time).

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Refer to the disclosure in Item 7 of the Management's Discussion and Analysis of Financial Condition and Results of Operations under the captions "Interest Rate Risk Management" and "Trading Activities".

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Item 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareholders of HSBC USA Inc.

We have audited the accompanying consolidated balance sheets of HSBC USA Inc. and subsidiaries (the Company) as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the years in the three year period ended December 31, 2003, and the accompanying consolidated balance sheets of HSBC Bank USA and subsidiaries (the Bank) as of December 31, 2003 and 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether

the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for

our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three year period ended December 31, 2003, and the financial position of the Bank as of December 31, 2003 and 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 7, the Company adopted prospectively the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, in 2002.

/s/ KPMG LLP

February 2, 2004 New York, New York

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HSBC USA Inc. 2003 CONSOLIDATED BALANCE SHEET

December 31, 2003 2002 ------- Assets in thousands Cash and due from banks $ 2,533,883 $ 2,081,279 Interest bearing deposits with banks 843,085 1,048,294 Federal funds sold and securities **purchased** under resale 2,445,511 2,742,943 agreements Trading **assets** 14,646,222 13,408,215 Securities available for sale 14,142,723 14,694,115 Securities held to maturity (fair value $4,647,713 and 4,511,629 4,628,482 $4,905,162) Loans 48,473,971 43,635,872 Less - allowance for credit losses 398,596 493,125

Loans, net 48,075,375 43,142,747 Premises and equipment 680,763 726,457 Accrued interest receivable 299,279 328,595 Equity investments 316,408 278,270 Goodwill 2,777,474 2,829,074 Other assets 4,289,366 3,517,730

Total assets $ 95,561,718 $ 89,426,201

Liabilities Deposits in domestic offices Noninterest bearing $ 6,092,560 $ 5,731,442 Interest bearing 38,995,090 34,902,431 Deposits in foreign offices Noninterest bearing 453,332 397,743 Interest bearing 18,414,475 18,798,723

Total deposits 63,955,457 59,830,339

Trading account liabilities 10,460,112 7,710,010 Short-term borrowings 6,782,134 7,392,368 Interest, taxes and other liabilities 3,088,469 3,422,047 Long-term debt 3,814,010 3,674,844

Total liabilities 88,100,182 82,029,608

Shareholders' equity Preferred stock 500,000 500,000 Common shareholder's equity Common stock, $5 par; Authorized -150,000,000 shares Issued - 704 shares 4 4 Capital surplus 6,027,001 6,056,307 Retained earnings 806,462 578,083 Accumulated other comprehensive income 128,069 262,199

Total common shareholder's equity 6,961,536 6,896,593

Total shareholders' equity 7,461,536 7,396,593

Total liabilities and shareholders' equity $ 95,561,718 $ 89,426,201

The accompanying notes are an integral part of the consolidated financial statements.

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HSBC USA Inc. 2003 CONSOLIDATED STATEMENT OF INCOME

Year Ended December 31, 2003 2002 2001 ------------- in thousands Interest income Loans $ 2,349,681 $ 2,521,200 $ 2,937,052 Securities 886,706 951,542 1,260,439 Trading assets 136,577 161,262 217,007 Short-term investments 79,736 149,400 345,150 Other interest income 20,632 23,366 27,853

Total interest income 3,473,332 3,806,770 4,787,501

Interest expense Deposits 666,336 973,575 1,904,386 Short-term borrowings 91,277 231,567 337,205 Long-term debt 205,478 225,352 280,618

Total interest expense 963,091 1,430,494 2,522,209

Net interest income 2,510,241 2,376,276 2,265,292 Provision for credit losses 112,929 195,000 238,400

Net interest income, after provision for credit losses 2,397,312 2,181,276 2,026,892

Other operating income Trust income 93,768 94,419 87,600 Service charges 211,733 206,423 189,025 Other fees and commissions 446,297 398,139 324,804 Other income 165,582 88,804 56,960 Mortgage banking revenue (expense) (102,606) 23,752 33,214 Trading revenues 290,632 130,079 254,812 Security gains, net 48,302 117,648 149,267

Total other operating income 1,153,708 1,059,264 1,095,682

3,551,020 3,240,540 3,122,574

Operating expenses Salaries and employee benefits 1,131,063 1,029,254 1,000,409 Occupancy expense, net 156,347 155,655 155,436 Goodwill amortization - - 176,482 Princeton Note Matter - - 575,000 Other expenses 752,465 690,558 635,658

Total operating expenses 2,039,875 1,875,467 2,542,985

Income before taxes and cumulative effect of accounting 1,511,145 1,365,073 579,589 change Applicable income tax expense 570,400 509,629 226,000

Income before cumulative effect of accounting change 940,745 855,444 353,589

Cumulative effect of accounting change - implementation of SFAS 133, net of tax - - (451)

Net income $ 940,745 $ 855,444 $ 353,138

The accompanying notes are an integral part of the consolidated financial statements.

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HSBC USA Inc. 2003 CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

2003 2002 2001

in thousands Preferred stock

Balance, January 1, $ 500,000 $ 500,000 $ 500,000

Balance, December 31, 500,000 500,000 500,000

Common stock Balance, January 1, 4 4 4

Balance, December 31, 4 4 4

Capital surplus Balance, January 1, 6,056,307 6,034,598 6,104,264 Return of capital (43,905) - (84,939) Other 14,599 21,709 15,273

Balance, December 31, 6,027,001 6,056,307 6,034,598

Retained earnings Balance, January 1, 578,083 415,821 612,798 Net income 940,745 855,444 353,138 Cash dividends declared: Preferred stock (22,366) (23,182) (25,115) Common stock (690,000) (670,000) (525,000)

Balance, December 31, 806,462 578,083 415,821

Accumulated other comprehensive income (loss) Balance, January 1, 262,199 98,607 116,851 Net change in unrealized gains on securities (174,629) 80,508 31,100 Net change in unrealized gain (loss) on derivatives classified as cash flow hedges 11,197 78,968 (37,503) Foreign currency translation adjustment 29,302 4,116 (11,841)

Other comprehensive income (loss), net of tax (134,130) 163,592 (18,244)

Balance, December 31, 128,069 262,199 98,607

Total shareholders' equity, December 31, $ 7,461,536 $ 7,396,593 $ 7,049,030

Comprehensive income Net income $ 940,745 $ 855,444 $ 353,138 Other comprehensive income (loss) (134,130) 163,592 (18,244)

Comprehensive income $ 806,615 $ 1,019,036 $ 334,894

The accompanying notes are an integral part of the consolidated financial statements.

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HSBC USA Inc. 2003 CONSOLIDATED STATEMENT OF CASH FLOWS

Year Ended December 31, 2003 2002 2001 ------------- in thousands Cash flows from operating activities Net income $ 940,745 $ 855,444 $ 353,138 Adjustments to reconcile net income to net cash provided (used) by operating activities Depreciation, amortization and deferred taxes 398,821 810,810 119,831 Provision for credit losses 112,929 195,000 238,400 Net change in other accrual accounts (959,656) (693,559) 897,893

Net change in loans originated for sale 1,032,677 (775,464) (665,273) Net change in trading assets and liabilities 448,255 (408,543) (1,752,622) Other, net (484,907) (585,592) (348,128)

Net cash provided (used) by operating 1,488,864 (601,904) (1,156,761) activities

Cash flows from investing activities Net change in interest bearing deposits with banks (396,319) 2,512,580 1,389,943 Net change in short-term investments 493,637 (95,601) (751,850) Purchases of securities held to maturity (2,677,475) (1,556,240) (545,874) Proceeds from maturities of securities held to 3,003,556 1,595,747 1,175,902 maturity Purchases of securities available for sale (13,827,092) (13,109,951) (15,585,510) Proceeds from sales of securities available for sale 3,636,698 7,032,407 12,395,526 Proceeds from maturities of securities available for 10,752,357 5,305,988 4,820,044 sale Net change in credit card receivables (85,601) (15,316) (11,937) Net change in other short-term loans 245,261 (374,180) 616,194 Net originations and maturities of long-term loans (3,130,777) (1,561,311) (551,253) Loans purchased (2,846,997) - - Sales of loans 668,548 189,905 79,666 Expenditures for premises and equipment (65,208) (82,821) (76,810) Net cash provided (used) in acquisitions, net of cash 403,263 23,221 (21,547) acquired Other, net (351,120) 25,126 92,975

Net cash provided (used) by investing (4,177,269) (110,446) 3,025,469 activities

Cash flows from financing activities Net change in deposits 4,405,072 2,399,319 (79,387) Net change in short-term borrowings (660,356) (978,648) (339,348) Issuance of long-term debt 270,588 978,765 23,262 Repayment of long-term debt (117,869) (1,021,996) (595,397) Contribution (return) of capital (43,905) 6,500 (84,939) Dividends paid (712,521) (693,067) (550,856)

Net cash provided (used) by financing 3,141,009 690,873 (1,626,665) activities

Net change in cash and due from banks 452,604 (21,477) 242,043 Cash and due from banks at beginning of year 2,081,279 2,102,756 1,860,713

Cash and due from banks at end of year $ 2,533,883 $ 2,081,279 $ 2,102,756

Cash paid for: Interest $ 990,172 $ 1,484,348 $ 2,721,880 Income taxes 330,746 210,610 259,387

The accompanying notes are an integral part of the consolidated financial statements.

Pending settlement receivable/payables related to securities and trading assets and liabilities are treated as non cash items for cash flows reporting.

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HSBC Bank USA 2003 CONSOLIDATED BALANCE SHEET

December 31, 2003 2002 ------- in thousands Assets Cash and due from banks $ 2,531,805 $ 2,079,940 Interest bearing deposits with banks 554,627 707,840 Federal funds sold and securities **purchased** under resale agreements 2,445,511 2,742,943 Trading **assets** 14,487,418 13,243,465 Securities available for sale 13,525,458 13,701,218 Securities held to maturity (fair value $4,453,356 and $4,639,939) 4,331,174 4,372,512 Loans 48,389,821 43,528,280 Less - allowance for credit losses 397,898 491,801

Loans, net 47,991,923 43,036,479 Premises and equipment 676,445 723,647 Accrued interest receivable 295,360 322,297 Equity investments 247,811 245,614 Goodwill 2,172,973 2,224,573 Other assets 3,697,618 3,015,241

Total assets $ 92,958,123 $ 86,415,769

Liabilities Deposits in domestic offices Noninterest bearing $ 6,064,846 $ 5,682,618 Interest bearing 38,995,090 34,902,431 Deposits in foreign offices Noninterest bearing 453,332 397,743 Interest bearing 19,033,289 19,731,918

Total deposits 64,546,557 60,714,710

Trading account liabilities 10,442,571 7,696,329 Short-term borrowings 5,516,678 5,907,951 Interest, taxes and other liabilities 2,718,768 3,147,260 Long-term debt 1,812,203 1,660,912

Total liabilities 85,036,777 79,127,162

Shareholder's equity Common shareholder's equity Common stock, $100 par; Authorized - 2,250,000 shares Issued - 2,050,002 shares 205,000 205,000 Capital surplus 6,925,306 6,454,612 Retained earnings 695,161 384,408 Accumulated other comprehensive income 95,879 244,587

Total shareholder's equity 7,921,346 7,288,607

Total liabilities and shareholder's equity $ 92,958,123 $ 86,415,769

The accompanying notes are an integral part of the consolidated financial statements.

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SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

HSBC USA Inc. (the Company), is a New York State based bank holding company, and is an indirect wholly owned subsidiary of HSBC Holdings plc (HSBC).

The accounting and reporting policies of the Company and its subsidiaries, including its principal subsidiary, HSBC Bank USA (the Bank), conform to accounting principles generally accepted in the United States of America and to predominant practice within the banking industry. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates.

Certain reclassifications have been made to prior year amounts to conform with current year presentations.

The following is a description of the significant policies and practices.

Principles of Consolidation

The financial statements of the Company and the Bank are consolidated with those of their respective wholly owned subsidiaries. All material intercompany transactions and balances have been eliminated. Investments in companies in which the percentage of ownership is at least 20%, but not more than 50%, are generally accounted for under the equity method and reported as equity investments.

Foreign Currency Translation

The accounts of the Company's foreign operations are measured using local currency as the functional currency. Assets and liabilities are translated into United States dollars at period end exchange rates. Income and expense accounts are translated at average monthly exchange rates. Net exchange gains or losses resulting from such translation are included in accumulated other comprehensive income and reported as a separate component of shareholders' equity. Foreign currency denominated transactions in other than the local functional currency are translated using the period end exchange rate with any foreign currency transaction gain or loss recognized currently in income.

Statement of Cash Flows

For the Company's consolidated statement of cash flows, cash and cash equivalents is defined as those amounts included in cash and due from banks.

Resale and Repurchase Agreements

The Company enters into purchases of securities under agreements to resell ("resale agreements") and sales of securities under agreements to repurchase ("repurchase agreements") of substantially identical securities. Resale agreements and repurchase agreements are generally accounted for as secured lending and secured borrowing transactions respectively.

The amounts advanced under resale agreements and the amounts borrowed under repurchase agreements are carried on the consolidated balance sheet at the amount advanced or borrowed. Interest earned on resale agreements and interest paid on repurchase agreements are reported as interest income

and

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interest expense respectively. The Company offsets resale and repurchase agreements executed with the same counterparty under legally enforceable netting agreements that meet the applicable netting criteria. The Company's policy is to take possession of securities purchased under resale agreements. The market value of the securities subject to the resale and repurchase agreements is regularly monitored to ensure appropriate collateral coverage of these secured financing transactions.

Securities

Debt securities that the Company has the ability and intent to hold to maturity are reported at cost, adjusted for amortization of premiums and accretion of discounts. Securities acquired principally for the purpose of selling them in the near term are classified as trading assets and reported at fair value, with unrealized gains and losses included in earnings. All other securities are classified as available for sale and carried at fair value, with unrealized gains and losses, net of related income taxes, included in accumulated other comprehensive income and reported as a separate component of shareholders' equity.

The fair value of securities and derivative contracts is based on current market quotations, where available or internal valuation models that approximate market pricing. The validity of internal pricing models is regularly substantiated by reference to actual market prices realized upon sale or liquidation of these instruments. If quoted market prices are not available, fair value is estimated based on the quoted price of similar instruments.

Realized gains and losses on sales of securities are computed on a specific identified cost basis and are reported within other operating income in the consolidated statement of income. Adjustments of trading assets to fair value and gains and losses on the sale of such securities are recorded in trading revenues.

The Company regularly evaluates its securities portfolios to identify losses in value that are deemed other than temporary. To the extent such losses are identified, a loss is recognized in current other operating income.

Loans

Loans are stated at their principal amount outstanding, net of unearned income, purchase premium or discount, unamortized nonrefundable fees and related direct loan origination costs. Loans held for sale are carried at the lower of aggregate cost or market value and remain presented as loans in the consolidated balance sheet. Interest income is recorded based on methods that result in level rates of return over the terms of the loans.

Commercial loans are categorized as nonaccruing when, in the opinion of management, reasonable doubt exists with respect to the ultimate collectibility of interest or principal based on certain factors including period of time past due (principally ninety days) and adequacy of collateral. At the time a loan is classified as nonaccruing, any accrued interest recorded on the loan is generally reversed and charged against income. Interest income on these loans is recognized only to the extent of cash received. In those instances where there is doubt as to collectibility of principal, any interest payments received are applied to principal. Loans are not reclassified as accruing until interest and principal payments are brought current and future payments are reasonably assured.

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Residential mortgages are generally designated as nonaccruing when delinquent for more than ninety days. Loans to credit card customers that are past due more than ninety days are designated as nonaccruing if the customer has agreed to credit counseling; otherwise they are charged off in accordance with a predetermined schedule. Other consumer loans are generally not designated as nonaccruing and are charged off against the

allowance for credit losses according to an established delinquency schedule.

Loans, other than those included in large groups of smaller balance homogenous loans, are considered impaired when, based on current information, it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. Impaired loans are valued at the present value of expected future cash flows, discounted at the loan's original effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent.

Restructured loans are loans for which the original contractual terms have been modified to provide for terms that are less than the Company would be willing to accept for new loans with comparable risk because of a deterioration in the borrowers' financial condition. Interest on these loans is accrued at the renegotiated rates.

Loan Fees

Nonrefundable fees and related direct costs associated with the origination or purchase of loans are deferred and netted against outstanding loan balances. The amortization of net deferred fees and costs are recognized in interest income, generally by the interest method, based on the estimated lives of the loans. Nonrefundable fees related to lending activities other than direct loan origination are recognized as other operating income over the period the related service is provided. This includes fees associated with the issuance of loan commitments where the likelihood of the commitment being exercised is considered remote. In the event of the exercise of the commitment, the remaining unamortized fee is recognized in interest income over the loan term using the interest method. Other credit-related fees, such as standby letter of credit fees, loan syndication and agency fees and annual credit card fees are recognized as other operating income over the period the related service is performed.

Allowance for Credit Losses

The Company maintains an allowance for credit losses that is, in the judgment of management, adequate to absorb estimated losses inherent in its commercial and consumer loan portfolios. A separate reserve for credit losses associated with certain off-balance sheet exposures including letters of credit, guarantees to extend credit and financial guarantees is also maintained and included in other liabilities. The adequacy of the allowance and this reserve is assessed within the context of both Statement of Financial Accounting Standards No. 114, Accounting by Creditors for Impairment of a Loan (SFAS 114), and Statement of Financial Accounting Standards No. 5, Accounting for Contingencies (SFAS 5), and is based upon an evaluation of various factors including an analysis of individual exposures, current and historical loss experience, changes in the overall size and composition of the portfolio, specific adverse situations, and general economic conditions. Provisions for all credit losses are recorded to earnings based upon the Company's periodic review of these and other pertinent factors. Actual loan losses are charged and recoveries are credited to the allowance.

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For commercial and select consumer loan assets, the Company conducts a periodic assessment of losses it believes to be inherent in the loan portfolio. When it is deemed probable, based upon known facts and circumstances, that full contractual interest and principal on an individual loan will not be collected, the asset is considered impaired. In accordance with SFAS 114, a "specific loss" impairment reserve is established based upon the present value of expected future cash flows, discounted at the loan's original effective interest rate, or as a practical expedient, at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent.

Formula-based reserves are also established against commercial loans and off balance sheet credit exposures in accordance with SFAS 5, when

based upon an analysis of relevant data, it is probable that a loss has been incurred and will be realized and the amount of that loss can be reasonably estimated, even though it has yet to manifest itself in a specifically identifiable loan asset. These reserves are determined by reference to continuously monitored and updated historical loss rates or factors, derived from a migration analysis which considers net charge off experience by loan and industry type, in relation to internal credit grading.

Homogeneous pools of loans including consumer installment, residential mortgage and credit cards are not assigned specific loan grades. Formula based reserves are generally determined based upon historical loss experience by loan type or in certain instances, by reference to specific collateral values.

Although the calculation of required formula reserves is a mechanical process incorporating historical data, the ultimate selection of reserve factors and the assessment of the overall adequacy of the allowance to provide for credit losses inherent in the loan portfolio involves a high degree of subjective management judgment. With recognition to the imprecision in estimating credit losses, and with consideration given to probable losses associated with factors including the impact of the national economic cycle, migration trends within non-criticized portfolios of loans, as well as portfolio concentration, the Company therefore also maintains an "unallocated reserve".

The Company gathers and analyzes historical data, updates assumptions relative to expected loss experience and reviews individual and portfolio loan assets on a quarterly basis. There have been no material changes in estimation techniques or loss reserve methodology during the year.

Mortgage Servicing Rights

The Company recognizes the right to service mortgages as a separate and distinct asset at the time the loans are sold. Servicing rights are then amortized in proportion to net servicing income and carried on the balance sheet in other assets at the lower of their initial carrying value, adjusted for amortization, or fair value.

As interest rates decline, prepayments generally accelerate, thereby reducing future net servicing cash flows from the mortgage portfolio. The carrying value of the mortgage servicing rights (MSRs) is periodically evaluated for impairment based on the difference between the carrying value of such rights and their current fair value. For purposes of measuring impairment which, if temporary is recorded through the use of a valuation reserve or, if permanent as a direct write-down, MSRs are stratified based upon interest rates and whether such rates are fixed or variable and other loan characteristics. Fair value is determined based upon the application of pricing valuation models incorporating portfolio specific prepayment assumptions. The reasonableness of these pricing models is periodically substantiated by reference to independent broker price quotations and actual market sales.

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If the carrying value of the servicing rights exceeds fair value, the asset is deemed impaired and impairment is recognized by recording a balance sheet valuation reserve with a corresponding charge to income.

The Company uses certain derivative financial instruments including constant maturity U.S. Treasury floors and interest rate swaps, to protect against the decline in economic value of servicing rights. These instruments have not been designated as qualifying hedges under SFAS 133 and are therefore recorded as trading instruments that are marked to market through earnings.

Goodwill and Other Acquisition Intangibles

On January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142). SFAS 142 requires that goodwill, including previously existing goodwill, and intangible assets with indefinite useful lives, not be amortized but rather tested for impairment at least annually. Under SFAS

142, all recorded goodwill must be assigned to one or more reporting units of the entity and evaluated for impairment at that level. Impairment testing requires that the fair value of each reporting unit be compared to its carrying amount, including the goodwill.

Goodwill, representing the excess of **purchase** price over the fair value of net **assets** acquired, results from **purchase** acquisitions made by the Company. Prior to the adoption of SFAS 142, goodwill and other acquisition intangibles were amortized over the estimated periods to be benefited, under the straight-line method, not exceeding 20 years.

Income Taxes

The Company and its subsidiaries are members of a larger group which files a consolidated federal income tax return.

Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, as well as the estimated future tax consequences attributable to net operating loss and tax credit carryforwards. A valuation allowance is established if, based on available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Foreign taxes paid are applied as credits to reduce federal income taxes payable.

Derivative Financial Instruments

On January 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). All derivatives are now recognized on the balance sheet at their fair value. On the date the derivative contract is entered into (January 1, 2001 for all derivatives in place at that date) the Company designates it as (1) a qualifying SFAS 133 hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment ("fair value" hedge); or (2) a qualifying SFAS 133 hedge of a forecasted transaction of the variability of cash flows to be received or paid related to a recognized asset or liability ("cash flow" hedge); or (3) as a trading position.

Changes in the fair value of a derivative that has been designated and qualifies as a fair value hedge, along with the changes in the fair value of the hedged asset or liability that is attributable to the hedged risk (including losses or gains on firm commitments), are recorded in current.

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period earnings. Changes in the fair value of a derivative that has been designated and qualifies as a cash flow hedge are recorded in other comprehensive income to the extent of its effectiveness, until earnings are impacted by the variability of cash flows from the hedged item. Changes in the fair value of derivatives held for trading purposes are reported in current period earnings.

At the inception of each hedge (January 1, 2001 for all derivatives in place at that date), the Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value or cash flow hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions.

Increased earnings volatility may result from the on-going mark to market of certain economically viable derivative contracts that do not satisfy the hedging requirements of SFAS 133, as well as from the hedge ineffectiveness associated with the qualifying contracts. The Company expects however that it will be able to continue to pursue its overall asset and liability risk management objectives using a combination of derivatives and cash instruments.

Embedded Derivatives

The Company may acquire or originate a financial instrument that contains a derivative instrument "embedded" within it. Upon origination or acquisition of any such instrument, the Company assesses whether the economic characteristics of the embedded derivative are clearly and closely related to the economic characteristics of the principal component of the financial instrument (i.e., the "host contract") and whether a separate instrument with the same terms as the embedded instrument would meet the definition of a derivative instrument.

When it is determined that (1) the embedded derivative possesses economic characteristics that are not clearly and closely related to the economic characteristics of the host contract; and (2) a separate instrument with the same terms would qualify as a derivative instrument, the embedded derivative is separated from the host contract, carried at fair value, and designated a trading instrument.

Hedge Discontinuation

The Company formally assesses, both at the hedge's inception and on an on-going basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items and whether they are expected to continue to be highly effective in future periods. If it is determined that a derivative is not highly effective as a hedge, or that in the future it ceases to be a highly effective hedge, the Company discontinues hedge accounting prospectively, as discussed below.

The Company discontinues hedge accounting prospectively when (1) the derivative is no longer effective in offsetting changes in the fair value or cash flows of a hedged item (including firm commitments or forecasted transactions); (2) the derivative expires or is sold, terminated, or exercised; (3) it is unlikely that a forecasted transaction will occur; (4) the hedged firm commitment no longer meets the definition of a firm commitment; or (5) the designation of the derivative as a hedging instrument is no longer appropriate.

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When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair value or cash flow hedge, the derivative will continue to be carried on the balance sheet at its fair value, and the hedged item will no longer be adjusted for changes in fair value or changes in the fair value of the derivative reclassified to other comprehensive income. If the hedged item was a firm commitment or forecasted transaction that is not expected to occur, any amounts recorded on the balance sheet related to the hedged item, including any amounts recorded in other comprehensive income, are reclassified to current period earnings. In all other situations in which hedge accounting is discontinued, the derivative will be carried at its fair value on the balance sheet, with changes in its fair value recognized in current period earnings unless redesignated as a qualifying SFAS 133 hedge.

Regulation

A description of bank regulatory matters affecting the Company is included in the Description of Business section under "Regulation, Supervision and Capital" on page 5 until the second table on page 6.

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NOTES TO FINANCIAL STATEMENTS

Note 1. Acquisitions/Divestitures

2003

On December 31, 2003 approximately $2.8 billion of residential mortgage loan **assets** were **purchased** from Household International, Inc. (Household).

On December 31, 2003 the Company sold its domestic factoring business to CIT Group Inc. Approximately $1 billion of gross loan assets and over $700 million of liabilities were sold for $325 million in cash. The transaction did not have a material effect on the 2003 results of the Company.

2001

On April 1, 2001, the Bank acquired approximately a 5 percent interest in the voting shares of HSBC Republic Bank (Suisse) S.A. (Swiss Bank), an affiliate wholly owned by the HSBC Group, in exchange for the contribution to the Swiss Bank of private banking businesses conducted by the Bank's Singapore and Hong Kong branches acquired as part of the Republic acquisition. The 5 percent interest represented the fair value estimate of the businesses transferred to the Swiss Bank and is being accounted for using the equity method of accounting due to the common control relationship of the entities. The Bank retained its banknotes activities in Singapore and its banknotes and foreign currency businesses in Hong Kong, and maintained its branch licenses in both locations.

The transaction was another step in an internal reorganization of the HSBC Group's global private banking operations, which began late in 2000. The Swiss Bank, a Switzerland based banking affiliate, manages much of the HSBC Group's worldwide private banking business. Swiss Bank is a foreign bank chartered and regulated under the banking laws of Switzerland.

On January 1, 2001, the Bank acquired the Panama branches of HSBC Bank plc for approximately $22 million in cash. The purchase included two branches in Panama City, one in the Colon Free Trade Zone, one in Colon and one in Aguadulce. The Bank acquired approximately $500 million in assets and assumed $450 million in customer and bank deposits. The acquisition was accounted for as a transfer of assets between companies under common control at HSBC Bank plc's historical cost.

Note 2. Trading Assets and Liabilities

An analysis of trading assets and liabilities follows.

December 31, 2003 2002 ------- in thousands Trading assets: U.S. Treasury $ 114,804 $ 523,908 U.S. Government agency 875,450 711,000 Asset backed securities 1,504,782 1,870,750 Corporate bonds 847,911 1,236,953 Other securities 1,344,506 693,986 Fair value of derivatives 7,652,596 5,418,705 Precious metals 2,306,173 2,952,913

$ 14,646,222 $ 13,408,215

Trading account liabilities: Securities sold, not yet purchased $ 913,958 $ 1,481,788 Payables for precious metals 1,181,237 1,183,243 Fair value of derivatives 8,364,917 5,044,979

$ 10,460,112 $ 7,710,010

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Note 3. Securities

At December 31, 2003 and 2002, the Company held no securities of any single issuer (excluding the U.S. Treasury and federal agencies) with a book value that exceeded 10% of shareholders' equity.

The amortized cost and fair value of the securities available for sale and securities held to maturity portfolios follow.

December 31, 2003 Amortized Gross Gross Fair Cost Unrealized Unrealized Value Gains Losses ---------- in thousands U.S. Treasury $ 213 $ 8 $ - $ 221 U.S. Government agency 10,778,055 154,921 141,012 10,791,964 Asset backed securities 1,784,272 7,427 5,818 1,785,881 Other domestic debt securities 414,924 1,057 35 415,946 Foreign debt securities 903,869 12,601 312 916,158 Equity securities 187,176 49,547 4,170 232,553

Securities available for sale $ 14,068,509 $ 225,561 $ 151,347 $ 14,142,723

U.S. Treasury $ 124,361 $ 88 $ - $ 124,449 U.S. Government agency 3,513,099 123,186 40,111 3,596,174 Obligations of U.S. states and political subdivisions 572,356 47,145 17 619,484 Other domestic debt securities 294,123 7,703 1,911 299,915 Foreign debt securities 7,690 1 - 7,691

Securities held to maturity $ 4,511,629 $ 178,123 $ 42,039 $ 4,647,713

December 31, 2002 Amortized Gross Gross Fair Cost Unrealized Unrealized Value Gains Losses ---------- in thousands U.S. Treasury $ 263,765 $ 2,001 $ - $ 265,766 U.S. Government agency 9,293,270 306,772 2,873 9,597,169 Asset backed securities 2,924,183 15,454 4,750 2,934,887 Other domestic debt securities 703,062 2,571 20 705,613 Foreign debt

securities 869,076 20,798 2,909 886,965 Equity securities 289,485 27,293 13,063 303,715

Securities available for sale $ 14,342,841 $ 374,889 $ 23,615 $ 14,694,115

U.S. Treasury $ 14,444 $ 6 $ - $ 14,450 U.S. Government agency 3,903,397 233,942 1,319 4,136,020 Obligations of U.S. states and political 672,787 44,452 746 716,493 subdivisions Other domestic debt securities 31,379 525 180 31,724 Foreign debt securities 6,475 - - 6,475

Securities held to maturity $ 4,628,482 $ 278,925 $ 2,245 $ 4,905,162

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A summary of gross unrealized losses and related fair values, classified as to the length of time the losses have existed, follows. The unrealized losses that have existed for more than one year related to asset backed securities are due to interest rate market conditions. The securities in question are high credit grade (i.e. AAA or AA) and no permanent impairment is expected to be realized. The unrealized losses that have existed for more than one year on equity securities are primarily related to seed money investments in mutual funds managed by an HSBC Group entity.

Less Than One Year Greater Than One Year

December 31, 2003 Gross Aggregate Gross Aggregate Unrealized Fair Value Unrealized Fair Value Losses of Losses of Investment Investment ---------- in thousands U.S. Government agency $ 140,814 $ 4,753,228 $ 198 $ 66,535 Asset backed securities 4,422 280,077 1,396 233,673 Other domestic debt securities 35 35,221 - - Foreign debt securities 136 60,854 176 12,598 Equity securities 1,099 11,488 3,071 10,129

Securities available for sale $ 146,506 $ 5,140,868 $ 4,841 $ 322,935

U.S. Government agency $ 40,111 $ 904,851 $ - $ - Obligations of U.S. states and political subdivisions - - 17 446 Other domestic debt securities 1,399 11,508 512 5,419

Securities held to maturity $ 41,510 $ 916,359 $ 529 $ 5,865

The following table presents realized gains and losses on investment securities transactions attributable to securities available for sale and securities held to maturity. Net realized gains of $22.4 million and $.5 million related to the securities available for sale portfolio are included in mortgage banking revenue in the consolidated statement of income for 2003 and 2002 respectively.

Year Ended December 31, Gross Gross Net Realized Realized Realized Gains (Losses) Gains (Losses) ------------- in thousands 2003 Securities available for sale $ 81,137 $ (10,734) $ 70,403 Securities held to maturity: Maturities, calls and mandatory redemptions 301 (11) 290

$ 81,438 $ (10,745) $ 70,693

2002 Securities available for sale $ 187,021 $ (69,903) $ 117,118 Securities held to maturity: Maturities, calls and mandatory redemptions 3,412 (2,361) 1,051

$ 190,433 $ (72,264) $ 118,169

2001 Securities available for sale $ 250,381 $ (102,671) $ 147,710 Securities held to maturity:

Maturities, calls and mandatory redemptions 1,578 (21) 1,557

$ 251,959 $ (102,692) $ 149,267

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The amortized cost and fair values of securities available for sale and securities held to maturity at December 31, 2003, by contractual maturity are shown in the following table. Expected maturities differ from contractual maturities because borrowers have the right to prepay obligations without prepayment penalties in certain cases. The amounts exclude $187 million cost ($233 million fair value) of equity securities that do not have maturities.

December 31, 2003 Amortized Fair Cost Value ---------- in thousands

Within one year $ 362,058 $ 362,407 After one but within five years 2,330,552 2,339,589 After five but within ten years 1,424,687 1,432,069 After ten years 9,764,036 9,776,105

Securities available for sale $ 13,881,333 $ 13,910,170

Within one year $ 149,079 $ 149,614 After one but within five years 171,996 182,397 After five but within ten years 226,962 243,592 After ten years 3,963,592 4,072,110

Securities held to maturity $ 4,511,629 $ 4,647,713

Note 4. Loans

A distribution of the loan portfolio follows.

December 31, 2003 2002 ------- in thousands Domestic: Commercial: Construction and mortgage loans $ 7,075,046 $ 6,350,036 Other business and financial 8,657,860 11,024,378 Consumer: Residential mortgages 26,294,464 20,437,891 Credit card receivables 1,111,763 1,101,067 Other consumer loans 1,904,484 1,693,224 International 3,430,354 3,029,276

$ 48,473,971 $ 43,635,872

Included in commercial loans for 2002 were $249.5 million of commercial mortgages and other commercial loans held for sale. Residential mortgages include $941.3 million and $1,838.1 million of mortgages held for sale at December 31, 2003 and 2002 respectively. Other consumer loans include $385.0 million and $372.8 million of higher education loans also held for sale at December 31, 2003 and 2002 respectively.

International loans include certain bonds issued by the government of Venezuela as part of debt renegotiations (Brady bonds). These bonds had an aggregate carrying value of $165.9 million (face value $177.5 million) at year end 2003 and 2002, and an aggregate fair value of $164.4 million and $141.9 million at year end 2003 and 2002 respectively. The Company's intent is to hold these instruments until maturity. The bonds are fully secured as to principal by zero-coupon U.S. Treasury securities with face value equal to that of the underlying bonds.

At December 31, 2003 and 2002, the Company's nonaccruing loans were $365.7 million and $387.4 million respectively. At December 31, 2003 and 2002, the Company had commitments to lend additional funds of $3.6 million and $12.3 million respectively, to borrowers whose loans are classified as nonaccruing. A significant portion of these commitments includes clauses that provide for cancellation in the event of a material adverse change in the financial position of the borrower.

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Year Ended December 31, 2003 2002 2001 ------------- in thousands Interest income on nonaccruing loans which would have been recorded had they been current in accordance with their original terms $ 27,696 $ 36,826 $ 30,565 Interest income recorded on nonaccruing loans 11,509 9,354 18,677

Other real estate and owned assets included in other assets amounted to $17.4 million and $16.6 million at December 31, 2003 and 2002 respectively.

The Company identified impaired loans totaling $266.8 million at December 31, 2003, of which $179.2 million had a related impairment reserve of $86.5 million. At December 31, 2002, the Company had identified impaired loans of $288.1 million of which $170.3 million had a related impairment reserve of $88.9 million. The average recorded investment in such impaired loans was $274.3 million, $288.2 million and $215.5 million in 2003, 2002 and 2001 respectively.

The Company has loans outstanding to certain executive officers and directors. The loans were made on substantially the same terms, including interest rates and collateral, as those prevailing at the same time for comparable transactions with other persons and do not involve more than normal risk of collectibility. The aggregate amount of such loans did not exceed 5% of shareholders' equity at December 31, 2003 and 2002.

Note 5. Allowance for Credit Losses

An analysis of the allowance for credit losses follows.

2003 2002 2001

in thousands Balance at beginning of year $ 493,125 $ 506,366 $ 524,984 Allowance related to acquisitions and (dispositions), net (15,567) (2,249) (18,987) Provision charged to income 112,929 195,000 238,400

Recoveries on loans charged off 50,964 35,301 42,821 Loans charged off (242,822) (240,926) (280,500) Translation adjustment (33) (367) (352)

Balance at end of year $ 398,596 $ 493,125 $ 506,366

Note 4 provides information on impaired loans and the related impairment reserve.

Included in the December 31, 2003 and December 31, 2002 allowance for credit losses are $33.2 million and $40.8 million respectively, of non-United States transfer risk reserves.

Note 6. Mortgage Servicing Rights

Residential mortgage loans serviced for others are not included in the accompanying consolidated balance sheets. The outstanding principal balances of these loans were $34.1 billion and $25.9 billion at December 31, 2003 and 2002 respectively. Custodial balances maintained in connection with the foregoing loan servicing, and included in noninterest bearing deposits in domestic offices, were $643.3 million and $841.0 million at December 31, 2003 and 2002 respectively.

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An analysis of residential MSRs, reported in other assets, follows.

2003 2002 2001

in thousands Balance at beginning of year $ 352,367 $ 314,272 $ 265,752 Additions 331,517 171,424 106,560 Amortizations (158,213) (76,989) (58,040) Provision for impairment * (26,550) (56,340) -

Balance at end of year $ 499,121 $ 352,367 $ 314,272

* Temporary impairment was recorded in a valuation reserve which has a balance of $23.0 million and $40.6 million at December 31, 2003 and 2002 respectively. See the following table.

The fair value of residential MSRs as of December 31, 2003, 2002 and 2001 was approximately $499.1 million, $352.4 million and $362.0 million respectively.

The following table summarizes the changes in the valuation reserve for residential MSRs.

2003 2002

in thousands Balance at beginning of year $ 40,591 $ - Temporary impairment 26,550 56,340 Write-down of MSRs (44,096) (15,749)

Balance at end of year $ 23,045 $ 40,591

In 2003, 2002 and 2001, the Company realized net gains from the sale of residential mortgages in securitizations, including those through agencies such as FHLMC, of $117.4 million, $163.7 million and $66.6 million respectively.

At December 31, 2003, the carrying value of residential MSRs was written down to their fair value of $499.1 million. That fair value was based on the present value of future cash flows, using a constant prepayment rate (CPR) of 17.4% annualized, a constant discount rate of 9.3% and a weighted average life of 5.0 years.

Note 7. Goodwill and Intangible Assets

The Company adopted the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (SFAS 142), on January 1, 2002. Under SFAS 142, goodwill is no longer amortized, but is reviewed for impairment at least annually at the reporting unit level. Identifiable intangible assets acquired in a business combination are amortized over their useful lives unless their useful lives are indefinite, in which case those intangible assets are tested for impairment annually. During the second quarter of 2003, the Company completed its annual impairment test of goodwill and determined that the fair value of each of the reporting units exceeded its carrying value. As a result, no impairment loss was required to be recognized.

In October 2002, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 147, Acquisitions of Certain Financial Institutions (SFAS 147), an amendment of FASB Statements No. 72 and 144 and FASB Interpretation No. 9. This statement removes acquisitions of financial institutions from the scope of both Statement

No. 72 and Interpretation No. 9 and requires that those transactions, which constitute a business, be accounted for in accordance with SFAS No. 141 and SFAS No. 142. Thus, the requirement in paragraph 5 of Statement No. 72 to recognize (and subsequently amortize) any excess of the fair value of liabilities assumed over the fair value of tangible and identifiable intangible assets acquired as an unidentifiable intangible asset no longer applies to acquisitions within the scope of SFAS 147.

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SFAS 147 is effective for acquisitions on or after October 1, 2002 with mandatory implementation effective January 1, 2002 for existing intangibles. The Company concluded that its acquisition of East River Savings Bank was within the scope of SFAS 147. As of December 31, 2001, the unamortized amount of unidentifiable intangible assets (i.e. excess premium SFAS 72) was $64.6 million. During the fourth quarter of 2002, this intangible asset was reclassified retroactively to January 1, 2002 to goodwill and no longer amortized but subject to annual impairment testing. The amortization previously recorded for the first three quarters of 2002 was reversed in accordance with SFAS 147.

The following table presents the consolidated results of operations adjusted as though the adoption of SFAS 142 occurred as of January 1, 2001.

2003 2002 2001

in thousands Reported net income $ 940,745 $ 855,444 $ 353,138 Goodwill amortization add-back - - 176,482

Adjusted net income $ 940,745 $ 855,444 $ 529,620

The following table presents all intangible assets of the Company that are being amortized. Given current market conditions relative to interest rates and prepayments, normally scheduled annual MSRs' amortization for the next five years would be approximately $90 million for the year ended 2004 declining gradually to approximately $40 million for the year ended 2008. Actual annual levels of MSRs' amortization could either increase or decrease dependent upon changes in interest rates, prepayment activity, new production and changes in strategy relative to sales of servicing rights. At December 31, 2003 intangible assets are as follows.

Intangible Assets Gross Accumulated Amortization Carrying Amortization Expense Amount 2003

in thousands Mortgage servicing rights $ 875,137 $ 372,412 * $ 185,488 ** Favorable lease arrangements 66,768 18,625 5,021

Total $ 941,905 $ 391,037 $ 190,509

* Includes a $23.0 million impairment valuation reserve.

** Includes $184.7 million of amortization and impairment charges related to residential mortgage activity and $.8 million related to commercial mortgage activity.

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Note 8. Deposits

The aggregate amount of time deposit accounts (primarily certificates of deposits) each with a minimum of $100,000 included in domestic office deposits were $6.98 billion and $5.60 billion at December 31, 2003 and 2002 respectively. The scheduled maturities of all domestic time deposits at December 31, 2003 follows.

in thousands 2004 $ 10,031,689 2005 983,601 2006 594,947 2007 133,519 2008 58,208 Later years 409,777

$ 12,211,741

Note 9. Short-Term Borrowings

The following table shows detail relating to short-term borrowings in 2003, 2002 and 2001. Average interest rates during each year are computed by dividing total interest expense by the average amount borrowed.

2003 2002 2001

Amount Rate Amount Rate Amount Rate

in thousands Federal funds purchased (day to day): At December 31 $ 1,718,097 .95 % $ 656,181 1.29 % $ 133,640 1.18 % Average during year

915,236 1.11 1,401,672 1.62 1,436,449 3.78 Maximum month-end balance 2,563,087 2,788,010 2,919,576 Securities sold under repurchase agreements: At December 31 357,223 1.45 552,583 1.52 377,059 1.25 Average during year 638,431 1.97 834,477 3.64 1,116,433 2.94 Maximum month-end balance 1,475,415 1,053,540 2,280,180 Commercial paper: At December 31 1,730,356 1.08 1,484,417 1.53 1,634,559 2.05 Average during year 1,405,508 1.21 1,496,367 1.79 1,218,242 3.77 Maximum month-end balance 1,730,356 1,787,276 1,642,520 Precious metals: At December 31 2,807,970 .78 3,083,397 .42 2,300,704 1.37 Average during year 3,436,540 .33 3,274,783 .51 2,200,346 1.13 Maximum month-end balance 3,734,699 3,865,153 2,544,318 All other short-term borrowings: At December 31 168,488 .97 1,615,790 1.46 4,756,124 2.32 Average during year 1,044,394 1.80 2,780,541 2.76 3,145,211 4.97 Maximum month-end balance 2,103,380 6,669,263 5,817,136

At December 31, 2003, the Company had unused lines of credit with HSBC Bank plc aggregating $500 million. These lines of credit do not require compensating balance arrangements and commitment fees are not significant. In addition, the Company, as a member of the New York Federal Home Loan Bank, has a secured borrowing facility in excess of $5 billion collateralized by residential mortgage loan assets.

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Note 10. Income Taxes

Total income taxes were allocated as follows.

Year Ended December 31, 2003 2002 2001 ------------- in thousands To income before income taxes $ 570,400 $ 509,629 $ 226,000 To shareholders' equity as tax charge (benefit): Net unrealized gains (losses) on securities available for sale (99,236) 41,407 20,638 Unrealized gain (loss) on derivatives classified as cash flow hedges 6,029 42,521 (20,194) Foreign currency translation, net 15,778 2,216 (6,383)

$ 492,971 $ 595,773 $ 220,061

The components of income tax expense follow.

Year Ended December 31, 2003 2002 2001 ------------- in thousands Current: Federal $ 364,781 $ (31,657) $ 384,849 State and local 47,829 10,393 60,987 Foreign 24,357 19,218 24,127

Total current 436,967 (2,046) 469,963 Deferred, primarily federal 133,433 511,675 (243,963)

Total income taxes $ 570,400 $ 509,629 $ 226,000

The following table is an analysis of the difference between effective rates based on the total income tax provision attributable to pretax income and the statutory U.S. Federal income tax rate.

Year Ended December 31, 2003 2002 2001 ------------- Statutory rate 35.0 % 35.0 % 35.0 % Increase (decrease) due to: State and local income taxes 3.1 4.2 1.8 Goodwill .9 - 9.8 Change in valuation allowance for deferred tax assets - - (4.9) Tax exempt interest income (.8) (1.0) (2.6) Other items (.5) (.9) (.1)

Effective income tax rate 37.7 % 37.3 % 39.0 %

The components of the net deferred tax position are summarized below.

December 31, 2003 2002 ------- in thousands Deferred tax assets: Allowance for credit losses $ 175,562 $ 177,680 Benefit accruals 93,326 128,620 Accrued expenses not currently deductible 41,473 88,785 Investment securities (38,446) 49,256 Net purchase discount on acquired companies 58,069 68,245 Other (26,929) 35,590

Total deferred tax assets 303,055 548,176

Less deferred tax liabilities: Unrealized gains on securities available for sale 30,515 129,751 Lease financing income accrued 35,825 62,405 Accrued pension cost 212,049 133,766 Accrued income on foreign bonds 10,787 16,161 Deferred net operating loss recognition - 113,468 Depreciation and amortization 49,786 118,484 Interest and discount income 47,120 42,901 Mortgage servicing rights 184,828 140,492

Total deferred tax liabilities 570,910 757,428

Net deferred tax asset (liability) $ (267,855) $ (209,252)

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Realization of deferred tax assets is contingent upon the generation of future taxable income or the existence of sufficient taxable income within the carryback period. Based upon the level of historical taxable income and the scheduled reversal of the deferred tax liabilities over the periods which the deferred tax assets are deductible, management believes that it is more likely than not the Company would realize the benefits of these deductible differences.

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Note 11. Long-Term Debt

Face Value Book Value

December 31, 2003 2002 2003 2002 ------- in thousands Issued or acquired by the Company or subsidiaries other than the Bank
Non-subordinated debt: **Floating Rate** Senior
Notes due 2004 (1.32%) $ 300,000 $ 300,000 $ 300,000 $ 300,000
8.375% Debentures due 2007 100,000 100,000 102,160 102,861

400,000 400,000 402,160 402,861

Subordinated debt: 7% Subordinated notes due 2006 300,000 300,000 299,286 299,034 5.875% Subordinated **notes** due 2008 250,000
250,000 233,308 229,794

6.625-9.70% Subordinated **notes** due 2009 550,000 550,000
599,940 619,594 **Floating Rate** Subordinated
Notes due 2009 (5.25%) 124,320 124,320 124,320 124,320 7%
Subordinated **notes** due 2011 100,000 100,000 116,508 116,279
9.50% Subordinated debentures due 2014 150,000 150,000 162,890 164,148
9.125-9.30% Subordinated notes due 2021 200,000 200,000 215,772 216,680
7.20% Subordinated debentures due 2097 250,000 250,000 215,549 215,181
Perpetual Capital Notes (1.438%) 129,000 129,000 124,674 124,133 7.53%
Junior Subordinated Debentures due 2026 206,186 - 216,313 - 7.75% Junior
Subordinated Debentures due 2026 154,640 - 142,025 - 7.808% Junior
Subordinated Debentures due 2026 206,186 - 206,186 - 8.38% Junior
Subordinated Debentures due 2027 206,186 - 206,186 - 7.85% Junior
Subordinated Debentures due 2032 309,279 - 285,976 -

3,135,797 2,053,320 3,148,933 2,109,163

Guaranteed mandatorily redeemable securities: 7.53% Capital
Securities due 2026 - 200,000 - 214,110 7.75% Capital Securities due 2026
- 150,000 - 136,832 7.808% Capital Securities due 2026 - 200,000 - 200,000
8.38% Capital Securities due 2027 - 200,000 - 200,000 7.85% Capital
Securities due 2032 - 300,000 - 300,000

- 1,050,000 - 1,050,942

Issued or acquired by the Bank or its subsidiaries Non-subordinated debt: Medium-Term **Floating Rate Notes** due
2004-2010 (1.12% to 1.17%) 149,555 - 149,555 - Medium-Term
Floating Rate Note due 2040 (0.99%)
24,999 24,999 24,999 24,999 Fixed **rate** Federal Home Loan Bank
of New York advances 17,253 14,128 17,253 14,128 Collateralized repurchase
agreements 18,817 18,777 18,817 18,777 Other 52,374 54,000 52,293 53,974

262,998 111,904 262,917 111,878

Total long-term debt $ 3,798,795 $ 3,615,224 $ 3,814,010 $ 3,674,844

The above table excludes $1,550 million of debt issued by the Bank or its subsidiaries payable to the Company. Of this amount, the earliest **note** to mature is in 2006 and the latest **note** to mature is in 2097.

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Interest **rates** on **floating rate notes** are determined periodically by formulas based on certain money market **rates** or, in certain instances, by minimum interest **rates** as specified in the agreements governing the issues. Interest **rates** on the **floating rate notes** in effect at December 31, 2003 are shown in parentheses.

The **Floating Rate** Senior **Notes** due 2004 represent unsecured obligations of the Company bearing interest at

the 3-month U.S. Dollar London Interbank offered **rate** plus 15 basis points. The **notes** are not redeemable prior to maturity in September 2004.

The 8.375% Debentures are direct unsecured general obligations of the Company and are not subordinated in right of payment to any other unsecured indebtedness of the Company. The Debentures are not redeemable prior to maturity in February 2007.

The Perpetual Capital Notes (PCNs) are a component of total qualifying capital under applicable risk-based capital rules. The PCNs may be exchanged for securities that constitute permanent primary capital securities for regulatory purposes. The principal amount of each PCN will be payable as follows: (1) at the option of the holder on the put date in each year commencing in 2012, (2) at the option of the Company on 90 days prior notice, the PCNs may be either (i) redeemed on the specified redemption date, in whole, for cash and at par, but only with the proceeds of a substantially concurrent sale of capital securities issued for the purpose of such redemption or (ii) exchanged, in whole, for capital securities having a market value equal to the principal amount of the PCNs, and, in each case, the payment of accrued interest in cash or (3) in the event that the sum of the Company's retained earnings and surplus accounts becomes less than zero, the PCNs will automatically be exchanged, in whole, for capital securities having a market value equal to the principal amount of the PCNs and the payment of accrued interest in cash.

Prior to the Company's adoption of FIN 46 at December 31, 2003, the statutory business trusts (issuer trusts) that issued guaranteed mandatorily redeemable securities (Capital Securities) were considered consolidated subsidiaries of the Company. The $1,050 million of Capital Securities issued by these trusts to third party investors, along with $32 million of common securities of the trusts (Common Securities) issued to the Company, were invested in Junior Subordinated Debentures of the Company. The Capital Securities were included in long-term debt on the Company's consolidated balance sheet and the Common Securities and Junior Subordinated Debentures were eliminated in consolidation. Upon adoption of FIN 46 the Company deconsolidated the issuer trusts. As a result, the Junior Subordinated Debentures issued by the Company to the trusts are now reflected in total long-term debt on the Company' s consolidated balance sheet at December 31, 2003. The Junior Subordinated Debentures, excluding the portion representing the Common Securities of the trusts, continue to qualify as Tier I capital under interim guidance issued by the Board of Governors of the Federal Reserve System ("Federal Reserve Board"), effective through the March 31, 2004 reporting period.

The Medium-Term **Floating Rate Notes** due 2004-2010 represent equity linked **notes** issued under the Bank's Global

Medium-Term **Note** Program, which provides for the issuance of up to $4 billion of **notes** having maturities of 7 days or more from the date of issuance. The Medium-Term **Floating Rate Note** due 2040 was also issued under this Program.

The fixed **rate** Federal Home Loan Bank of New York advances have interest **rates** ranging from 2.01% to 7.24%.

The collateralized repurchase agreements consist of securities repurchase agreements with initial maturities exceeding one year. The repurchase agreements have fixed rates ranging from 4.97% to 7.16%.

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Contractual scheduled maturities for total long-term debt over the next five years are as follows: 2004, $390 million; 2005, $28 million; 2006, $306 million; 2007, $119 million and $280 million in 2008.

Note 12. Preferred Stock

The following table presents information related to the issues of preferred stock outstanding.

Shares Dividend Amount Outstanding Rate Outstanding 2003 2003

December 31, 2003 2002 ------- in thousands $1.8125 Cumulative Preferred Stock ($25 stated value) 3,000,000 7.25 % $ 75,000 $ 75,000 6,000,000 Depositary shares each representing a one-fourth interest in a share of Adjustable Rate Cumulative Preferred Stock, Series D ($100 stated value) 1,500,000 4.50 150,000 150,000 Dutch Auction Rate Transferable Securities (TM) Preferred Stock (DARTS) Series A ($100,000 stated value) 625 1.286 62,500 62,500 Series B ($100,000 stated value) 625 1.283 62,500 62,500 $2.8575 Cumulative Preferred Stock ($50 stated value) 3,000,000 5.715 150,000 150,000 CTUS Inc. Preferred Stock 100 - - -

$ 500,000 $ 500,000

The $1.8125 Cumulative Preferred Stock may be redeemed, as a whole or in part, at the option of the Company at $25 per share plus dividends accrued and unpaid to the redemption date.

The dividend rate on the Adjustable Rate Cumulative Preferred Stock, Series D (Series D Stock) is determined quarterly, by reference to a formula based on certain benchmark market interest rates, but will not be less than 41/2% or more than 101/2% per annum for any applicable dividend period. The Series D Stock is redeemable, as a whole or in part, at the option of the Company at $100 per share (or $25 per depositary share), plus accrued and unpaid dividends to the redemption date.

DARTS of each series are redeemable at the option of the Company, as a whole or in part on any dividend payment date, at $100,000 per share, plus accrued and unpaid dividends to the redemption date. Dividend rates for each dividend period are set pursuant to an auction procedure. The maximum applicable dividend rates on the shares of DARTS range from 110% to 150% of the 60 day "AA" composite commercial paper rate. DARTS are also redeemable at the option of the Company, as a whole but not in part, on any dividend payment date at a redemption price of $100,000 per share plus the payment of accrued and unpaid dividends, if the applicable rate for such series fixed with respect to the dividend period for such series ending on such dividend payment date equals or exceeds the 60 day "AA" composite commercial paper rate in effect on the date of determination of such rate.

The outstanding shares of $2.8575 Cumulative Preferred Stock have an aggregate stated value of $150 million. The Cumulative Preferred Stock may be redeemed at the option of the Company, as a whole or in part, on or after October 1, 2007 at $50 per share, plus dividends accrued and unpaid to the redemption date.

The Company acquired CTUS Inc., a unitary thrift holding company in 1997 from CT Financial Services Inc. (the Seller). CTUS owned First Federal Savings and Loan Association of Rochester (First Federal). The acquisition agreement

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provided that the Company issue preferred shares to the Seller. The preferred shares provide for, and only for, a contingent dividend or redemption equal to the amount of recovery, net of taxes and costs, if any, by First Federal resulting from the pending action against the United States government alleging breaches by the government of contractual obligations to First Federal following passage of the Financial Institutions Reform, Recovery and Enforcement Act of 1989. The Company issued 100 preferred shares at a par value of $1.00 per share in connection with the acquisition.

Note 13. Retained Earnings

Bank dividends are a major source of funds for payment by the Company of shareholder dividends and along with interest earned on investments, cover the Company's operating expenses which consist primarily of interest on outstanding debt. The approval of the Federal Reserve Board is required if the total of all dividends declared by the Bank in any year exceeds the net profits for that year, combined with the retained profits for the two preceding years. Under a separate restriction, payment of dividends is prohibited in amounts greater than undivided profits then on hand, after deducting actual losses and bad debts. Bad debts are debts due and unpaid

for a period of six months unless well secured, as defined, and in the process of collection.

Under the more restrictive of the above rules the Bank can pay dividends to the Company as of December 31, 2003 of approximately $568 million, adjusted by the effect of its net income (loss) for 2004 up to the date of such dividend declaration.

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Note 14. Accumulated Other Comprehensive Income

Accumulated other comprehensive income includes net income as well as certain items that are reported directly within a separate component of shareholders' equity. The following table presents changes in accumulated other comprehensive income balances.

2003 2002 2001

in thousands Unrealized gains on securities Balance, January 1, $ 235,948 $ 155,440 $ 124,340 Increase (decrease) in fair value, net of taxes of $(74,595), $82,398, and $72,307 in 2003, 2002 and 2001 respectively (128,867) 156,635 127,141 Reclassification adjustment for (gains) losses included in net income, net of taxes of $24,641, $40,991 and $51,669 in 2003, 2002 and 2001 respectively (45,762) (76,127) (96,041)

Net change (174,629) 80,508 31,100

Balance, December 31, 61,319 235,948 155,440

Unrealized gain (loss) on derivatives classified as cash flow hedges Balance, January 1, 41,465 (37,503) - Change in unrealized gain (loss) on derivatives classified as cash flow hedges, net of taxes of $6,029, $42,521 and $(20,194) in 2003, 2002 and 2001 respectively 11,197 78,968 (37,503) Unrealized net transitional gain related to initial adoption of SFAS 133 - - 2,853 Amortization of unrealized transitional SFAS 133 gains credited to current income - - (2,853)

Net change 11,197 78,968 (37,503)

Balance, December 31, 52,662 41,465 (37,503)

Foreign currency translation adjustment Balance, January 1, (15,214) (19,330) (7,489)

Translation gains (losses) net of taxes of $15,778, $2,216 and $(6,383) in 2003, 2002 and 2001 respectively 29,302 4,116 (11,841)

Net change 29,302 4,116 (11,841)

Balance, December 31, 14,088 (15,214) (19,330)

Total accumulated other comprehensive income at December 31, $ 128,069 $ 262,199 $ 98,607

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Note 15. Related Party Transactions

In the normal course of business, the Company conducts transactions with HSBC, including its 25% or more owned subsidiaries (HSBC Group). These transactions occur at prevailing market rates and terms. The following table presents related party transaction balances at year end and the total income and expense generated by those transactions.

December 31, 2003 2002 2001 ------- in millions Assets: Interest bearing deposits with banks $ 139 $ 130 $ 564 Loans 330 338 142 Other 34 38 33

Total assets $ 503 $ 506 $ 739

Liabilities: Deposits $ 7,512 $ 6,140 $ 4,686 Short-term borrowings 735 267 114 Other 79 349 34

Total liabilities $ 8,326 $ 6,756 $ 4,834

Interest income $ 17 $ 28 $ 46 Interest expense 91 87 160 HSBC charges (1) 102 81 72

(1) Various members of the HSBC Group provide operational, information technology related and administrative support to the Company. The majority of these charges relate to support provided to the Company's treasury and traded markets businesses.

At December 31, 2003 and 2002, the aggregate notional amounts of all derivative contracts with other HSBC affiliates were $168 billion and $88 billion respectively.

Extensions of credit by the Company to other HSBC affiliates are legally required to be secured by eligible collateral.

Pursuant to various service agreements, the Company will pay fees for sourcing, underwriting, pricing and on-going servicing functions related to residential mortgage loans recorded as a result of the relationship with Household.

Refer to Note 1 for discussions of the Company's acquisition and divestiture transactions with other HSBC Group members.

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Note 16. Stock Option Plans and Restricted Share Plans

Options have been granted to employees of the Company under the HSBC Holdings Group Share Option Plan (the Group Share Option Plan), the HSBC Holdings Executive Share Option Scheme (the Executive Share Option Plan) and under the HSBC Holdings Savings-Related Share Option Plan: Overseas Section (the Sharesave Plans). Since the shares and contribution commitment have been granted directly by HSBC, the offset to compensation expense was a credit to capital surplus, representing a contribution of capital from HSBC.

Group Share Option Plan

The Group Share Option Plan is a discretionary long-term incentive compensation plan available to certain Company employees, based on performance criteria and potential, with grants usually made each year. Options are granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions. This plan was adopted by the Company during 2001.

Total options granted were 4,076,000 in 2003, 4,615,000 in 2002 and 4,084,000 in 2001. The fair value of options granted was $3.01 per option in 2003, $2.33 per option in 2002 and $3.38 per option in 2001. Compensation expense recognized amounted to $11.2 million, $6.6 million and $3.0 million in 2003, 2002 and 2001 respectively.

Executive Share Option Plan

The Executive Share Option Plan is a discretionary long-term incentive compensation plan available to certain Company employees, based on performance criteria and potential, with grants usually made each year. Options are granted at market value and are normally exercisable between the third and tenth anniversaries of the date of grant, subject to vesting conditions. No further grants have been made under this plan since the adoption of the Group Share Option Plan.

Compensation expense recognized related to this plan amounted to $1.0 million, $3.6 million and $4.9 million in 2003, 2002 and 2001 respectively. Since all remaining options granted under the Executive Share Option Plan are now fully vested, no further expense is expected to be recognized for this plan.

Sharesave Plans

The Sharesave Plans invite eligible employees to enter into savings contracts to save up to $400 per month, with

the option to use the savings to acquire shares. There are currently two types of plans offered which allow the participant to select savings contracts of either a 5 year or 3 year length. The options are exercisable within six months following the third or fifth year respectively of the commencement of the related savings contract, at a 20 percent discount for options granted in 2003, 2002 and 2001.

Total options granted under the 5 year vesting period were 737,000 in 2003, 524,000 in 2002 and 495,000 in 2001. The fair value of options granted was $3.29 per option in 2003, $3.53 per option in 2002, and $3.84 per option in 2001. Compensation expense recognized amounted to $.7 million, $2.6 million and $2.7 million in 2003, 2002 and 2001 respectively.

Total options granted under the 3 year vesting period were 910,000 in 2003, 691,000 in 2002 and 803,000 in 2001. The fair value of options granted was $3.20 per option in 2003, $3.63 per option in 2002 and $3.60 per option in 2001. Compensation expense recognized amounted to $1.4

million in 2003, $1.2 million in 2002 and $.5 million in 2001.

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Prior to the Sharesave Plans being offered to employees in its present form, eligible employees could elect to participate through the Company's 401(k) plan and acquire contributions based on HSBC stock at 85% of market value on the date of grant. An employee's agreement to participate was a five year commitment. At the end of each five year period employees receive the appreciation of the HSBC stock over the initial exercise price credited to their 401(k) account. Eligibility for this plan was discontinued after 1999 with the adoption of the Sharesave Plans. Compensation expense related to this plan amounted to $.3 million in 2003, $2.1 million in 2002 and $2.4 million in 2001.

Fair values of share options, measured at the date of grant of the option, are calculated using a model that is based on the underlying assumptions of the Black-Scholes model. The fair values calculated are inherently subjective and uncertain due to the assumptions made and the limitations of the model used. The significant assumptions used to estimate the fair value of options granted are as follows.

2003 Group Share Sharesave Sharesave Option Plan Plan Plan 5 Year 3 Year --- Risk free interest rate 4.68 % 4.24 % 4.01 % Expected life (years) 5 5 3 Expected volatility 30 % 30 % 30 %

2002 Group Share Sharesave Sharesave Option Plan Plan Plan 5 Year 3 Year --- Risk free interest rate 5.57 % 5.57 % 5.46 % Expected life (years) 5.25 5.25 3.25 Expected volatility 25 % 30 % 30 %

2001 Group Share Sharesave Sharesave Option Plan Plan Plan 5 Year 3 Year --- Risk free interest rate 5.65 % 5.50 % 5.40 % Expected life (years) 10 5.5 3.5 Expected volatility 30 % 30 % 30 %

Restricted Share Plans

HSBC and the Company grant awards to key individuals in the form of performance and non-performance restricted shares. The awards are based on an individual's demonstrated performance and future potential. Performance related restricted shares generally vest after three years from date of grant, based on HSBC's Total Shareholder Return (TSR) relative to the TSR of the benchmark during the performance period. TSR is defined as the growth in share value and declared dividend income during the period and the benchmark is composed of HSBC's peer group of financial institutions. If the performance conditions are met, the shares vest and are released to the recipients two years later. Non-performance restricted shares are released to the recipients based on continued service, typically at the end of a three year vesting period. Total expense recognized for the plan for 2003, 2002 and 2001 was $40.3 million, $28.2 million and $23.7 million respectively.

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Note 17. Postretirement Benefits

The Company, the Bank and certain other subsidiaries maintain noncontributory defined benefit pension plans covering substantially all of their employees hired prior to January 1, 1997 and those employees who joined the Company through acquisitions and were participating in a defined benefit plan at the time of acquisition. Certain other HSBC subsidiaries participate in these plans.

The Company also maintains unfunded noncontributory health and life insurance coverage for all employees who retired from the Company and were eligible for immediate pension benefits from the Company's retirement plan. Employees retiring after 1992 will absorb a portion of the cost of these benefits. Employees hired after that same date are not eligible for these benefits. A premium cap has been established for the Company's share of retiree medical cost.

On December 8, 2003, the President signed into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The accumulated postretirement benefit obligation and net periodic benefit cost listed below do not reflect the effects of the Act on the plan. As authoritative guidance to implement the Act has not been issued, the

Company is unable to assess the impact on the accumulated postretirement obligation and the net periodic benefit cost. The issued guidance could require the Company to change previously reported information.

The measurement date for all plans described above is December 31. The following table provides data concerning the Company's benefit plans.

Pension Benefits Other

Postretirement Benefits

2003 2002 2003 2002

in thousands Change in benefit obligation Benefit obligation, January 1 $ 952,437 $ 824,582 $ 126,652 $ 100,603 Service cost 28,917 25,826 2,265 2,274 Interest cost 63,756 59,862 7,073 7,388 Participant contributions - - 325 349 Plan amendment - 639 (2,043) - Actuarial (gain) loss 91,210 70,973 (1,647) 24,629 Benefits paid (33,996) (29,445) (9,065) (8,591)

Benefit obligation, December 31 $ 1,102,324 $ 952,437 $ 123,560 $ 126,652

Change in plan assets Fair value of plan assets, January 1 $ 877,622 $ 774,127 $ - $ - Actual return on plan assets 203,081 (132,060) - - Company contribution 175,000 265,000 8,740 8,242 Participant contributions - - 325 349 Benefits paid (33,996) (29,445) (9,065) (8,591)

Fair value of plan assets, December 31 $ 1,221,707 $ 877,622 $ - $ -

Funded status of plan Funded status, December 31 $ 119,383 $ (74,815) $ (123,560) $ (126,652) Unrecognized actuarial (gain) loss 389,482 446,855 11,685 13,332 Unrecognized prior service cost 4,470 5,613 - - Unrecognized net transition obligation - - 27,181 32,471

Recognized amount $ 513,335 $ 377,653 $ (84,694) $ (80,849)

Amount recognized in the consolidated balance sheet Prepaid benefit cost $ 513,335 $ 377,653 $ - $ - Accrued benefit liability - - (84,694) (80,849)

Recognized amount $ 513,335 $ 377,653 $ (84,694) $ (80,849)

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The accumulated benefit obligation for the defined benefit pension plan was $942,823 and $820,577 at December 31, 2003 and 2002 respectively.

Operating expenses for 2003, 2002 and 2001 included the following components.

Pension Benefits Other Postretirement Benefits

2003 2002 2001 2003 2002 2001

in thousands Net periodic benefit cost Service cost $ 28,917 $ 25,826 $ 25,232 $ 2,265 $ 2,274 $ 2,228 Interest cost 63,756 59,862 55,523 7,073 7,388 6,579 Expected return on plan assets (87,005) (83,974) (79,689) - - - Prior service cost amortization 1,143 1,187 944 - - - Actuarial (gain)/loss 32,507 9,159 - - - (527) Transition amount amortization - - - 3,247 3,247 3,247

Net periodic benefit cost $ 39,318 $ 12,060 $ 2,010 $ 12,585 $ 12,909 $ 11,527

Weighted-average assumptions to determine benefit obligations at December 31 Discount rate 6.25 % 6.75 % 7.25 % 5.75 % 6.25 % 6.75 % Rate of compensation increase 3.75 3.75 4.00 3.75 (1) 3.75 (1) 4.00 (1)

Weighted-average assumptions to determine net cost for years ended December 31 Discount rate 6.75 % 7.25 % 7.75 % 6.25 % 6.75 % 7.25 % Expected return on plan assets 8.75 9.50 9.50 - - - Rate of compensation increase 3.75 4.00 4.50 3.75 4.00 4.50

(1) Applicable to life insurance only.

The Company determines its expected long-term rate of return based upon historical market returns of equities and fixed income investments adjusted for the mix between these instruments. Additional factors are considered such as the rate of inflation and interest rates. The expected long-term rate of return is validated by comparison to independent sources, which include actuarial consultants and investment advisors.

Net periodic pension cost includes $2.4 million, $1.6 million and $1.1 million for 2003, 2002 and 2001 respectively recognized in the financial statements of other HSBC subsidiaries participating in the Company's pension plan.

Assumed Health Care Cost Trend Rates

December 31 2003 2002 ------- Health care cost trend rate assumed for next year 7 % 7 % Rate that the cost trend rate gradually declines to 7 % 7 % Year that the rate reaches the ultimate rate 2003 2002

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Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects.

One One Percentage Percentage Point Point Increase Decrease

in thousands Effect on total service and interest cost $ 275 $ (262) Effect on postretirement benefits obligation 3,170 (2,982)

Plan Assets

The Company's pension plan weighted-average asset allocation at December 31, 2003 and 2002 by asset category are as follows.

Percentage of Plan Assets

December 31 2003 2002 ------- Equity securities 62 % 61 % Debt securities 38 28 Cash and cash equivalents - 11

Total 100 % 100 %

The Company's Investment Committee has developed an asset allocation policy based on the plan's objectives, characteristics of the pension liabilities, and asset projections. In addition, the Committee considered industry practices, the current market environment, and practical investment issues. The Company is cognizant of the fact that diversification is necessary to reduce unnecessary risk. Therefore the pension fund is diversified across several asset classes and securities. The Committee discussed "traditional" asset classes (i.e., publicly traded securities) as well as "alternative" asset classes (e.g., private equity, hedge funds, real estate, etc.), but decided it was not comfortable with alternative asset classes at this time. The current policy is described below.

Asset Class Target Allocation Percentage -------- Equity securities 60 % Debt securities 40

Total 100 %

The Company strives to maximize the possibility of having sufficient funds to meet the long-term liabilities of the pension fund. To do so, the Company must achieve a fine balance between the goals of growing the assets of the plan and keeping risk at an acceptable level. A key factor in shaping the Company's attitude towards risk is the long-term investment horizon of the pension fund. The long-term horizon enables the plan to tolerate the risk of somewhat volatile investment returns in the short run with the expectation of higher returns in the long run.

The Committee has examined the plan's risk tolerance from the perspective of participant demographic characteristics, funding characteristics and business/financial characteristics. Based on its assessment of these characteristics and risk preference, the Company believes that its overall risk posture is average relative to the typical pension plan. Consequently, the Company believes an average equity exposure is appropriate for its pension fund.

Cash Flows

The Company expects to contribute nothing for pension benefits and approximately $9 million for other postretirement benefits during fiscal year 2004.

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Defined Contribution Plans

Employees hired after December 31, 1996 become participants in a defined contribution plan after one year of service. Contributions to the plan are based on a percentage of employees' compensation. Total expense recognized for the plan was $7.8 million in 2003, $3.0 million in 2002 and $3.0 million in 2001.

The Company maintains a 401(k) plan covering substantially all employees. Contributions to the plan by the Company are based on employee contributions. Total expense recognized for the plan was $18.0 million in

2003, $16.3 million in 2002 and $15.1 million in 2001.

Note 18. Business Segments

The Company reports and manages its business segments consistently with the line of business groupings used by HSBC. As a result of HSBC line of business changes, the Company altered the business segments that it used in 2002 to reflect the movement of certain domestic private banking activities from the Personal Financial Services Segment to the Private Banking Segment. Also activity related to selected commercial customers was moved from the Commercial Banking Segment to the Corporate, Investment Banking and Markets Segment. Prior year disclosures have been conformed herein to the presentation of current segments.

The Company has four distinct segments that it utilizes for management reporting and analysis purposes. These segments are based upon products and services offered and are identified in a manner consistent with the requirements outlined in Statement of Financial Accounting Standards No. 131, Disclosures about Segments of an Enterprise and Related Information (SFAS 131). See the Business Segments sections for additional disclosure regarding the Company's operating segments: Business Segments on page 30 and segment results table on page 31.

Note 19. Collateral, Commitments and Contingent Liabilities

The following table presents pledged assets included in the consolidated balance sheet.

December 31, 2003 2002 ------- in millions Interest bearing deposits with banks $ 140 $ 65 Trading assets 647 1,770 Securities available for sale 4,171 6,083 Securities held to maturity 956 1,607 Loans 360 343

Total $ 6,274 $ 9,868

In accordance with the Statement of Financial Accounting Standards No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS 140), debt securities pledged as collateral that can be sold or repledged by the secured party continue to be reported on the consolidated balance sheet. The fair value of securities available for sale that can be sold or repledged at December 31, 2003 and 2002 was $349 million and $1,936 million respectively.

The fair value of collateral accepted by the Company not reported on the consolidated balance sheet that can be sold or repledged at December 31, 2003 and 2002 was $1,655 million and $3,011 million respectively. This collateral was obtained under security resale agreements. Of this collateral, $1,138 million at December 31, 2003 has been sold or repledged as collateral under

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repurchase agreements or to cover short sales compared with $2,428 million at December 31, 2002.

The Company and its subsidiaries are obligated under a number of noncancellable leases for premises and equipment. Certain leases contain renewal options and escalation clauses. Rental expense under all operating leases, net of sublease rentals, was $63.2 million, $58.1 million and $60.1 million in 2003, 2002 and 2001 respectively. Minimum future rental commitments on operating leases in effect at December 31, 2003 were as follows: 2004, $68 million; 2005, $59 million; 2006, $46 million; 2007, $39 million; 2008, $29 million; and $86 million thereafter.

Note 20. Litigation

The Company is named in and is defending legal actions in various jurisdictions arising from its normal business. None of these proceedings is regarded as material litigation. In addition, there are certain proceedings related to the "Princeton Note Matter" that are described below.

In relation to the Princeton Note Matter, as disclosed in the Company's 2002 Annual Report on Form 10-K, two of the noteholders were not included in the settlement and their civil suits are continuing. The U.S. Government excluded one of them from the restitution order (Yakult Honsha Co., Ltd.) because a senior officer of the noteholder was being criminally prosecuted in Japan for his conduct relating to its Princeton Notes. The

senior officer in question was convicted during September 2002 of various criminal charges related to the sale of the Princeton Notes. The U.S. Government excluded the other noteholder (Maruzen Company, Limited) because the sum it is likely to recover from the Princeton Receiver exceeds its losses attributable to its funds transfers with Republic New York Securities Corporation as calculated by the U.S. Government. Both of these civil suits seek compensatory, punitive, and treble damages pursuant to RICO and assorted fraud and breach of duty claims arising from unpaid Princeton Notes with face amounts totaling approximately $125 million. No amount of compensatory damages is specified in either complaint. These two complaints name the Company, the Bank, and Republic New York Securities Corporation as defendants. The Company and the Bank have moved to dismiss both complaints. The motion is fully briefed and sub judice. Mutual production of documents took place in 2001, but additional discovery proceedings have been suspended pending the Court's resolution of the motions to dismiss.

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Note 21. Derivative Instruments and Hedging Activities

The Company is party to various derivative financial instruments as an end user (1) for asset and liability management purposes; (2) in order to offset the risk associated with changes in the value of various assets and liabilities accounted for in the trading account; (3) to protect against changes in value of its mortgage servicing rights portfolio; and (4) for trading in its own account.

The Company is also an international dealer in derivative instruments denominated in U.S. dollars and other currencies which include futures, forwards, swaps and options related to interest rates, foreign exchange rates, equity indices, commodity prices and credit, focusing on structuring of transactions to meet clients' needs.

Fair Value Hedges

Specifically, interest rate swaps that call for the receipt of a variable market rate and the payment of a fixed rate are utilized under fair value strategies to hedge the risk associated with changes in the risk free **rate** component of the value of certain fixed **rate** investment securities. Interest **rate** swaps that call for the receipt of a fixed **rate** and payment of a **variable** market **rate** are utilized to hedge the risk associated with changes in the risk free **rate** component of certain fixed **rate debt obligations.**
Additionally, beginning in December 2002, the Company established a qualifying hedge strategy using forward sales contracts to offset the fair value changes of certain conventional closed mortgage loans originated for sale.

Where the critical terms of the hedge instrument are identical at hedge inception, the short-cut method of accounting is utilized. As a result, no retrospective or prospective assessment of effectiveness is required and no hedge ineffectiveness is recognized. However, in instances where the short-cut method of accounting cannot be applied, the cumulative dollar offset method is utilized in order to satisfy the retrospective and prospective assessment of hedge effectiveness for SFAS 133.

For the year ended December 31, 2003, the Company recognized a net gain of $.2 million compared with a net gain of $7.5 million for the year ended December 31, 2002 and a net loss of $.6 million for the year ended December 31, 2001 (reported as mortgage banking revenue and/or other income in the consolidated statement of income), which represented the ineffective portion of all fair value hedges. Only the time value component of these derivative contracts has been excluded from the assessment of hedge effectiveness.

Cash Flow Hedges

Similarly, interest rate swaps and futures contracts that call for the payment of a fixed rate are utilized under the cash flow strategy to hedge the forecasted repricing of certain deposit liabilities and

commercial loan assets. In order to initially qualify for hedge accounting, assessment of hedge effectiveness is demonstrated on a prospective basis utilizing both regression analysis and the cumulative dollar offset method. In order to satisfy the retrospective assessment of hedge effectiveness, the cumulative dollar offset method is utilized and ineffectiveness is recorded to the income statement on a monthly basis.

For the year ended December 31, 2003, the Company recognized a net gain of $3.4 million compared with a net gain of $12.7 million for the year ended December 31, 2002 and a net gain of $8.5 million for the year ended December 31, 2001 (reported as a component of other income in the consolidated

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statement of income), which represented the total ineffectiveness of all cash flow hedges. Only the time value component of these derivative contracts has been excluded from the assessment of hedge effectiveness.

Gains or losses on derivative contracts that are reclassified from accumulated other comprehensive income to current period earnings pursuant to this strategy, are included in interest expense on deposit liabilities during the periods that net income is impacted by the repricing. As of December 31, 2003, $10.0 million of deferred net losses on derivative instruments accumulated in other comprehensive income are expected to be charged to earnings during 2004.

Trading and Other Activities

The Company enters into certain derivative contracts for purely trading purposes in order to realize profits from short-term movements in interest rates, commodity prices, foreign exchange rates and credit spreads. In addition, certain derivative contracts are accounted for on a full mark to market basis through current earnings even though they were acquired for the purpose of protecting the economic value of certain assets and liabilities.

Credit and Market Risks

By using derivative instruments, the Company is exposed to credit and market risks. If the counterparty fails to perform, credit risk is equal to the fair value gain in a derivative. When the fair value of a derivative contract is positive, this generally indicates that the counterparty owes the Company, and, therefore, creates a repayment risk for the Company. When the fair value of a derivative contract is negative, the Company owes the counterparty and, therefore, it has no repayment risk.

The Company minimizes the credit (or repayment) risk in derivative instruments by entering into transactions with quality counterparties including other members of the HSBC Group. Counterparties include financial institutions, government agencies, both foreign and domestic, corporations, funds (mutual funds, hedge funds, etc.), insurance companies and private clients. These counterparties are subject to regular credit review by the Company's credit risk management department. The Company generally requires that derivative contracts be governed by an International Swaps and Derivatives Association Master Agreement. Depending on the type of counterparty and the level of expected activity, bilateral collateral arrangements may be required as well. When the Company has more than one transaction with a counterparty and has a legally enforceable master netting agreement in place with that counterparty, the net positive mark to market value, less the amount of collateral, if any, should represent the measure of current credit exposure with that counterparty as of the reporting date.

Market risk is the adverse effect that a change in interest rates, currency, or implied volatility rates has on the value of a financial instrument. The Company manages the market risk associated with interest rate and foreign exchange contracts by establishing and monitoring limits as to the types and degree of risk that may be undertaken. The Company also manages the market risk associated with the trading derivatives through hedging strategies that correlate the rates, price and spread

movements. The Company measures this risk daily by using Value at Risk (VAR) and other methodologies.

The Company's Asset and Liability Policy Committee is responsible for monitoring and defining the scope and nature of various strategies utilized to manage interest rate risk that are developed through its analysis of data from financial simulation models and other internal and industry sources. The resulting hedge strategies are then incorporated into the Company's overall interest rate risk management and trading strategies.

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Company Names: HSBC Holdings PLC
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Naics Codes/Descriptions: 52211 (Commercial Banking); 522 (Credit Intermediation & Related Activities); 5221 (Depository Credit Intermediation); 52 (Finance & Insurance); 55111 (Management of Companies & Enterprises); 551111 (Offices of Bank Holding Companies); 551112 (Offices of Other Holding Companies)

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RELEASE OF CARNIVAL CORPORATION & PLC ANNUAL REPORT ON FORM 10-K A
ND

PRELIMINARY ANNOUNCEMENT OF CARNIVAL PLC FINANCIAL INFORMATION FOR THE ELEV
EN

MONTHS ENDED NOVEMBER 30, 2003

Carnival Corporation & plc announced its fourth quarter and annual

results

of operations in its earnings release issued on December 18, 2003. As requ
ired

by the UK Listing Authority ("UKLA"), Carnival Corporation & plc is her
eby

announcing that it has filed with the U.S. Securities and Exchange Commissi
on

("SEC") a joint Annual Report on Form 10-K today containing the Carnival

Corporation & plc 2003 annual financial statements, which results remai
n

unchanged from those previously announced on December 18, 2003. However,

Carnival Corporation & plc has updated its fiscal 2004 outlook, which u
pdate is
included in Schedule A.

The information included in the attached Schedules A and B is extracte
d

from the Form 10-K and has been prepared in accordance with SEC rules and

regulations. Schedules A and B contain the audited annual consolidated fina
ncial

statements for Carnival Corporation & plc as of and for the twelve mont
hs ended

November 30, 2003, together with management's discussion and analysis of

financial condition and results of operations. These Carnival Corporation
& plc

consolidated financial statements have been prepared in accordance with

accounting principles generally accepted in the United States ("U.S. GAAP")
, and

include the consolidated results of Carnival Corporation from December 1, 2
002

to November 30, 2003 and prior years comparative data and the consolidated

results of Carnival plc (formerly known as P&O Princess Cruises plc) fr
om April

17, 2003 to November 30, 2003. The boards and management believe that this

Carnival Corporation & plc U.S. GAAP financial information is the most

meaningful presentation to shareholders of both Carnival Corporation and

Carnival plc as it presents the financial condition and results of operatio
ns of

the dual listed company, Carnival Corporation & plc, in which both grou

ps of
shareholders hold their economic interest.

In addition, in accordance with the requirements of the UKLA, the Dire
ctors

are today presenting in the attached Schedule C the preliminary announcemen
t of

final results for Carnival plc for the eleven month period ended November 3
0,

2003. The Carnival plc group standalone financial information excludes the

results of Carnival Corporation and is prepared under UK GAAP. The financi
al

information set out within Schedule C does not constitute Carnival plc's

statutory accounts for the periods ended December 31, 2002 and November 30,

2003. Statutory accounts for 2002 have been delivered to the registrar of

companies, whereas those for 2003 will be delivered following Carnival plc'
s

annual general meeting. The auditors have reported on those accounts; thei
r

reports were unqualified and did not contain statements under section 237(2
)
or (3) of the Companies Act 1985.

MEDIA CONTACTS:	INVESTOR RELATIONS CONTACTS:
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Carnival Corporation & plc	Carnival Corporation & pl c
Tim Gallagher	Beth Roberts
001 305 599 2600, ext. 16000	001 305 406 4832
UK	UK
Brunswick Group	Bronwen Griffiths
Sophie Fitton/Sarah Tovey	023 8052 5231
020 7404 5959	

The full joint Annual Report on Form 10-K (including the portion extra
cted

for this release) is available for viewing on the SEC Web site at www.sec.g
ov

under Carnival Corporation or Carnival plc, the Carnival Corporation Web si
te at

www.carnivalcorp.com and the Carnival plc Web site at www.carnivalplc.com.
A

copy of the joint Annual Report on Form 10-K will be available shortly at t

he

UKLA Document Viewing Facility of the Financial Services Authority at 25 Th
e
North Colonnade, London E14 5HS.

Carnival Corporation & plc

Carnival Corporation & plc is the largest cruise vacation group in
the

world, with a portfolio of 12 cruise brands in North America, Europe and

Australia, comprised of Carnival Cruise Lines, Holland America Line, Prince
ss

Cruises, Windstar Cruises, Seabourn Cruise Line, AIDA, Costa Cruises, Cunar
d

Line, Ocean Village, P&O Cruises, Swan Hellenic and P&O Cruises Aus
tralia.

Together, these brands operate 73 ships totalling more than 118,000 lo
wer

berths with 11 new ships scheduled for delivery between now and mid-2006.

Carnival Corporation & plc also operates the leading tour companies in
Alaska

and the Canadian Yukon, Holland America Tours and Princess Tours. Traded on
both

the New York and London Stock Exchanges, Carnival Corporation & plc is
the only

group in the world to be included in both the S&P 500 and the FTSE 100
indices.

Additional information can be obtained via Carnival Corporation &
plc's Web

sites at www.carnivalcorp.com and www.carnivalplc.com or by writing to Carn
ival

plc at Carnival House, 5 Gainsford Street, London SE1 2NE, United Kingdom.

SCHEDULE A

CARNIVAL CORPORATION & PLC - MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS UNDER U.S. GAAP

Cautionary Note Concerning Factors That May Affect Future Results

Some of the statements contained in this 2003 Annual Report are "forwa
rd-

looking statements" that involve risks, uncertainties and assumptions with

respect to us, including some statements concerning future results, plans, outlook, goals and other events which have not yet occurred. These statements are intended to qualify for the safe harbors from liability provided by Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934. You can find many, but not all, of these statements by looking for words like "will," "may," "believes," "expects," "anticipates," "forecast," "future," "intends," "plans," and "estimates" and for similar expressions.

Because forward-looking statements involve risks and uncertainties, there are many factors that could cause our actual results, performance or achievements to differ materially from those expressed or implied in this 2003 Annual Report. Forward-looking statements include those statements which may impact the forecasting of our earnings per share, net revenue yields, booking levels, pricing, occupancy, operating, financing and tax costs, costs per available lower berth day, estimates of ship depreciable lives and residual values, outlook or business prospects. These factors include, but are not limited to, the following:

- achievement of expected benefits from the DLC transaction;
- risks associated with the DLC structure;
- risks associated with the uncertainty of the tax status of the DLC structure;
- general economic and business conditions, which may impact levels of disposable income of consumers and net revenue yields for our cruise brands;
- conditions in the cruise and land-based vacation industries, including competition from other cruise ship operators and providers of other vacation alternatives and increases in capacity offered by cruise ship and land-based vacation alternatives;
- the impact of operating internationally;
- the international political and economic climate, armed conflicts, terrorist attacks, availability of air service and other world events a

nd
adverse publicity, and their impact on the demand for cruises;

- accidents and other incidents affecting the health, safety, security an
d
vacation satisfaction of passengers;

- our ability to implement our shipbuilding programs and brand strategies and to continue to expand our business worldwide;

- our ability to attract and retain qualified shipboard crew and maintain good relations with employee unions;

- our ability to obtain financing on terms that are favorable or consiste
nt
with our expectations;

- the impact of changes in operating and financing costs, including chang
es
in foreign currency and **interest**
rates and fuel, food, payroll, insurance
and **security** costs;

- changes in the tax, environmental, health, safety, security and other regulatory regimes under which we operate;
- continued availability of attractive port destinations;

- our ability to successfully implement cost improvement plans and to integrate business acquisitions;

- continuing financial viability of our travel agent distribution system;
- weather patterns or natural disasters; and

- the ability of a small group of shareholders to effectively control the outcome of shareholder voting.

Forward-looking statements should not be relied upon as a prediction of

actual results. Subject to any continuing obligations under applicable law
or

any relevant listing rules, we expressly disclaim any obligation to dissemi
nate,

after the date of this 2003 Annual Report, any updates or revisions to any
such

forward-looking statements to reflect any change in expectations or events, conditions or circumstances on which any such statements are based.

Executive Overview

Over the past three years our net revenue yields have declined (see "K
ey

Performance Indicators" below). We believe this decline has been a result
of a

number of factors affecting consumers' vacation demand including, among oth
er

things, armed conflicts in the Middle East and elsewhere, terrorist attacks in the U.S. and elsewhere, minor passenger and crew illnesses, the uncertain worldwide economy and adverse publicity surrounding these and other events. In addition to these concerns, the recent large increase in new ship capacity in the cruise industry over this period has intensified competition to attract customers from land-based vacation alternatives, which has also contributed to lower cruise ticket prices.

In addition to the lower pricing trends over this period, the cruise industry has also experienced historically high fuel costs; significant increases in insurance and security costs, precipitated by the events of September 11, 2001; and higher environmental costs, resulting primarily from upgrading environmental compliance programs. It is possible that some of these increasing cost trends will continue in the future. However, as we have done in the past, we expect to be able to partially offset these increases through the continuing benefits of scale, as well as cost containment measures.

The factors mentioned above have put pressure on our earnings over this period, especially since most of our costs are largely fixed once we put a ship into service. Although it is impossible to quantify the financial impact on us of each of the foregoing factors, these events adversely impacted the entire leisure and travel industry in general, and the cruise industry and us in particular.

During 2003, we were able to complete the largest acquisition in our history, the DLC transaction with P&O Princess. We have made significant progress in integrating our two organizations, including announcing the expected redeployment in late 2004 of CCL's Jubilee to the P&O Cruises

Australia fleet, the transfer of a Holland America newbuild shipyard slot to Princess for a new ship deployment in 2006, the consolidation of our German and London office operations and the sale of our German river boat business, global procurement savings and the implementation of many best practices among our brands. As a result, we are well on our way to realizing the $100 million of annual DLC transaction synergies we initially targeted.

In addition, during the second half of 2003, we saw a strong rebound in our booking volumes, which commenced shortly after the conclusion of the Iraqi war, although our cruise ticket prices were still somewhat lower than last year.

As mentioned above, the entire cruise industry had a large increase in capacity during this three year period, including our introduction of seven new ships into service during 2003. Even with our 17.5% pro forma capacity increase in fiscal 2003, we were able to maintain our occupancy level at over 103%. As a large part of our operating costs are fixed in nature, we strategically manage our prices to enable us to fill our ships at the highest possible prices, since incremental passengers contribute to our fixed costs. Our ability to maintain these high occupancy levels helped us to achieve an increasing level of onboard and other revenues, which partially offset the impact of lower cruise ticket prices.

Throughout this period, despite the adverse external travel and leisure environment and the significant increase in cruise industry capacity, we generated significant cash flows. These results provide an indication of the strength of our business. However, our operations are subject to many risks, as briefly noted above and under the caption "Cautionary Note Concerning Factors That May Affect Future Results," which could significantly impact o

ur
future results.

The year over year percentage increases in Carnival Corporation & plc's available lower berth day ("ALBD") capacity for fiscal 2004 (versus fiscal 2003 pro forma ALBD, assuming that the DLC transaction was completed and Carnival plc was consolidated for the full period in 2003), 2005 and 2006, resulting primarily from new ships entering service, is currently expected to be 17.5%, 9.2% and 5.3%, respectively.

We believe that given a more stable geopolitical environment, our net revenue yields will increase in 2004, despite the expected significant increase in our 2004 passenger capacity.

Outlook For Fiscal 2004 ("2004")

As of December 18, 2003, we said that we expected our first quarter 2004 earnings per share to be in the range of $0.17 to $0.20 versus 2003 pro forma first quarter earnings per share of $0.16 ($0.18 less a $0.02 per share non-recurring gain from insurance settlements). We also said that we were comfortable with consensus earnings estimates for the 2004 year, which at that time was $1.98 per share, assuming no significant geopolitical or economic shocks.

Since early January, the cruise industry has entered the "wave season" (a period of higher booking levels than during the rest of the year). As we had expected, bookings during this year's wave season have been significantly higher than during the comparable period last year, which was adversely impacted by the build up to the war in Iraq. Since the beginning of January, company wide booking levels have been running 59% higher than during the same period last year, which is significantly above the company's 17.5% proforma capacity increase for 2004.

We now expect that first quarter 2004 net revenue yields will increase 3% to 4% (versus an increase of 1% to 2% in our previous guidance) and net cruise costs per ALBD, will be at the low end of our previous guidance of an increase of 1% to 3%. The increase in expected net revenue yields is largely due to the weakening of the U.S. dollar, and to a lesser extent, higher than expected pricing on close to sailing bookings. The weak dollar also had the effect of increasing net cruise costs per ALBD, however that is expected to be more than offset by lower than anticipated advertising costs, which is partially timing and is expected to be expended later in the year, and lower than forecasted fuel costs. We now expect first quarter 2004 earnings per share to be in the range of $0.21 to $0.22.

Net revenue yields for the year 2004 are now forecast to increase 5% to 7%, versus our previous forecast of an increase of 2% to 4%. The increase in expected net revenue yields is largely due to weakness in the U.S. dollar (our current guidance is based on an exchange rate of $1.27 to the euro and $1.84 to the sterling), and to a lesser extent, strengthening booking levels noted during wave season. Net cruise costs per ALBD is forecast to increase 2% to 3% versus our earlier guidance of flat compared to 2003 proforma costs. The increase in expected net cruise costs per ALBD is due to the weaker U.S. dollar.

Carnival Corporation's 2% Notes become convertible if the share price of its common stock closes above $43.05 for 20 days out of the last 30 trading days of the quarter. If the 2% Notes become convertible, earnings per share

for the full year 2004 will be reduced by $0.02 per share. Assuming this dilution occurs, we are comfortable with the current consensus 2004 earnings estimates of $2.02 per share, assuming no geopolitical or economic shocks.

Income Taxes

The new U.S. income tax regulations under Section 883 of the Internal Revenue Code have become effective for us in 2004. Although we are still in the process of analyzing the impact of these new rules on our operations, based upon our preliminary analysis, we currently estimate that their application will reduce our 2004 earnings per share by approximately $0.02 to $0.03.

Key Performance Indicators

We use net cruise revenues per ALBD ("net revenue yields") and net cruise costs per ALBD as significant non-GAAP financial measures of our cruise segment financial performance. We believe that net revenue yields are commonly used in the cruise industry to measure a company's revenue performance and pricing power. This measure is also used for revenue management purposes. In calculating net revenue yields, we use net cruise revenues rather than gross cruise revenues. We believe that "net cruise revenues" is a more meaningful measure in determining revenue yield than gross cruise revenues because it reflects the cruise revenues earned by us net of its most significant variable costs (travel agent commissions, cost of air transportation and certain other variable direct costs associated with onboard revenues). Substantially all of our remaining cruise costs are largely fixed once our ship capacity levels have been determined.

Net cruise costs per ALBD is the most significant measure we use to monitor our ability to control costs. In calculating this measure, we exclude the same variable costs as described above, which are included in the calculation of net cruise revenues. This is done to avoid duplicating these variable costs in the two non-GAAP financial measures described above.

Critical Accounting Estimates

Our critical accounting estimates are those which we believe require our most significant judgments about the effect of matters that are inherently uncertain. A discussion of our critical accounting estimates, the underlying judgments and uncertainties used to make them and the likelihood that materially different estimates would be reported under different conditions or using different assumptions, is set forth below.

Ship Accounting

Our most significant assets are our ships and ships under construction, which represent 78% of our total assets. We make several critical accounting estimates dealing with our ship accounting. First, we compute our ships' depreciation expense, which represents 11.9% of our cruise operating expenses in fiscal 2003, which requires us to estimate the average useful life of each of our ships, as well as their residual values. Secondly, we account for ship improvement costs by capitalizing those costs, which we believe will add value to our ships and depreciate those improvements over their estimated useful lives. Finally, we account for the replacement or refurbishment of our ship components and recognize the resulting loss in our results of operations.

We determine the average useful lives of our ships based primarily on our estimates of the average useful lives of the ships' major component systems, such as cabins, main diesels, main electric, superstructure and hull. In addition, we consider, among other things, the impact of anticipated technological changes, long-term vacation market conditions and competition and historical useful lives of similarly-built ships. We have estimated our new ships' average useful lives at 30 years and their residual values at 15% of our original ship cost.

Given the very large and complex nature of our ships, ship accounting estimates require considerable judgment and are inherently uncertain. We do not have cost segregation studies performed to specifically componetize our ship systems; therefore, our overall estimates of the relative costs of these component systems are based principally on general and technical information known about major ship component system lives and our knowledge of the cruise industry. In addition, we do not identify and track the depreciation of specific component systems, but instead utilize estimates when determining the net cost basis of assets being replaced or refurbished. If materially different conditions existed, or if we materially changed our assumptions of ship lives and residual values, our depreciation expense or loss on replacement or refurbishment of ship assets and net book value of our ships would be materially different. In addition, if we change our assumptions in making our determinations as to whether improvements to a ship add value, the amounts we expense each year as repair and maintenance costs could increase, partially offset by a decrease in depreciation expense, as less costs would have been initially capitalized to our ships. Our fiscal 2003 ship depreciation expense would have increased by approximately $18 million for every year we reduced our estimated average 30 year ship useful life. In addition, if our ships were estimated to have no residual value, our fiscal 2003 depreciation expense would have increased by approximately $78 million. Some ships in our fleet are over 30 years old.

We believe that the estimates we made for ship accounting purposes are reasonable and our methods are consistently applied and, accordingly, result in depreciation expense that is based on a rational and systematic method to equitably allocate the costs of our ships to the periods during which services

are obtained from their use. In addition, we believe that the estimates we made are reasonable and our methods consistently applied (1) in determining the average useful life and residual values of our ships; (2) in determining which ship improvement costs add value to our ships; and (3) in determining the net cost basis of ship component assets being replaced or refurbished. Finally, we believe our critical ship accounting estimates are generally comparable with those of other major cruise companies.

Asset Impairment

The impairment reviews of our ship and trademark assets and of our goodwill, which has been allocated to our reporting units, such as our cruise lines, require us to make significant estimates to determine the fair values, including the cash flows, of these assets or reporting units.

The determination of fair value includes numerous uncertainties, unless a viable actively traded market exists for the asset or for a comparable reporting unit, which is usually not the case for cruise ships, cruise lines and trademarks. For example, in determining fair values of ships and cruise lines utilizing discounted forecasted cash flows, significant judgments are made concerning, among other things, future net revenue yields, net cruise costs per ALBD, interest and discount rates, cruise itineraries, ship additions and retirements, technological changes, consumer demand, governmental regulations and the effects of competition. In addition, third party appraisers are sometimes used to determine fair values and some of their valuation methodologies are also subject to similar types of uncertainties. Also, the determination of fair values of reporting units using a price earnings multiple approach also requires significant judgments, such as determining reasonably comparable multiples. Finally, determining trademark fair values also requires significant judgments in determining both the estimated trademark cash flows, and the appropriate royalty rates to be

applied to those cash flows to determine their fair value. We believe that we have made reasonable estimates and judgments in determining whether our ships, goodwill and trademarks have been impaired. However, if there is a material change in the assumptions used in our determination of fair value or if there is a material change in the conditions or circumstances influencing fair value, we could be required to recognize a material impairment charge.

Contingencies

We periodically assess the potential liabilities related to any lawsuits or claims brought against us, as well as for other known unasserted claims, including environmental, legal and tax matters. While it is typically very difficult to determine the timing and ultimate outcome of these matters, we use our best judgment to determine if it is probable that we will incur an expense related to the settlement or final adjudication of such matters and whether a reasonable estimation of such probable loss, if any, can be made. In assessing probable losses, we make estimates of the amount of insurance recoveries, if any. We accrue a liability when we believe a loss is probable and the amount of the loss can be reasonably estimated, in accordance with the provisions of SFAS No. 5, "Accounting for Contingencies," as amended. Such accruals are typically based on developments to date, management's estimates of the outcomes of these matters, our experience in contesting, litigating and settling other similar matters and any related insurance coverage. See Notes 9 and 14 in the accompanying financial statements for additional information concerning our contingencies.

Given the inherent uncertainty related to the eventual outcome of these matters and potential insurance recoveries, it is possible that all or some

of these matters may be resolved for amounts materially different from any provisions or disclosures that we may have made with respect to their resolution. In addition, as new information becomes available, we may need to reassess the amount of probable liability that needs to be accrued related to our contingencies. All such revisions in our estimates could materially impact our results of operations and financial position.

Property, Plant and Equipment Draft Statement of Position

In late 2003, the Accounting Standards Executive Committee issued a new Statement of Position draft, entitled "Accounting for Certain Costs and Activities Related to Property, Plant and Equipment" ("PP&E SOP"), the adoption of which is subject to the final clearance of the FASB. If issued in its new form, the PP&E SOP would allow us the choice of selecting the level at which we componetize our ships, as long as the identified components are at or below the "functional unit level", which is the ship itself. If we elect to identify and track ship components below the ship level, the PP&E SOP will require us, among other things, to maintain very detailed historical cost records for these ship parts and determine separate depreciable lives for each component, which may result in changes in the amount and timing of depreciation and repair and maintenance expenses and the amount of loss recognized on the replacement or refurbishment of ship parts. Alternatively, the PP&E SOP allows us to identify our entire ship as one component; however, electing each ship as one component will require us to expense as incurred all otherwise capitalizable expenditures incurred after the ship is placed into service, rather than capitalize and depreciate these expenditures over their estimated useful lives. In addition, the PP&E SOP will require us to expense our dry-dock costs as incurred, instead of amortizing our dry-dock costs to expense generally over one year.

We have not decided what level of componentization we will choose nor have we completed an analysis of the impact this PP&E SOP would have on our financial statements, although it may be material, dependent upon the alternatives we choose in relation to identifying components. The PP&E SOP is expected to be effective for fiscal years beginning after December 15, 2004 (fiscal 2006 for us), with earlier application encouraged.

Results of Operations

We earn our cruise revenues primarily from the following:

- sales of passenger cruise tickets and, in some cases, the sale of air and other transportation to and from our ships. The cruise ticket price includes accommodations, meals, entertainment and many onboard activities, and

- the sale of goods and/or services primarily on board our ships, which include bar and beverage sales, casino gaming, shore excursions, gift shop and spa sales, photo and art sales and pre-and post cruise land packages. These activities are either performed directly by us or by independent concessionaires, from which we receive a percentage of their revenues.

We incur cruise operating costs and expenses for the following:

- the costs of passenger cruise tickets which represent costs that vary directly with passenger cruise ticket revenues, and include travel agent commissions, air and other travel related costs and credit card fees,

- onboard and other cruise costs which represent costs that vary directly with onboard and other revenues, and include the costs of liquor and beverages, costs of tangible goods sold from our gift, photo and art auction activities, pre-and post cruise land packag

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and credit card fees. Concession revenues do not have any significant amount of costs associated with them, as the costs and services incurred for these activities are provided by our concessionaires,

- payroll and related costs which represent costs for all our shipboard personnel, including deck and engine officers and crew and hotel and administrative employees,

- food costs which include both our passenger and crew food costs, and

- other ship operating costs which include fuel, repairs and maintenance, port charges, insurance, entertainment and all other shipboard operating costs and expenses.

We do not allocate payroll and related costs, food costs or other ship operating costs to the passenger cruise ticket costs or to onboard and other cruise costs since they are incurred to support the total cruise experience and do not vary significantly with passenger levels.

For segment information related to our revenues, expenses, operating income and other financial information see Note 13 in the accompanying financial statements. Operations data expressed as a percentage of total revenues and selected statistical information were as follows (a):

	Years Ended November 30,		
	2003	2002	2001
Revenues			
Cruise			
Passenger tickets	75.0%	76.3%	77.6%
Onboard and other	21.1	20.5	18.5
Other	3.9	3.2	3

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	100.0	100.0	100.0
Costs and Expenses			
Operating			
Cruise			
Passenger tickets	15.2	15.0	17.9
Onboard and other	3.4	2.7	2.6
Payroll and related	11.1	10.5	10.1
Food	5.8	5.8	5.8
Other ship operating	18.4	16.7	15.2
Other	2.9	2.5	3.0
Total	56.8	53.2	54.6
Selling and administrative	13.9	13.9	13.6
Depreciation and amortization	8.7	8.7	8.2
Impairment charge		0.4	3.0
Loss from affiliated operations, net			1.0
Operating Income	20.6	23.8	19.6
Nonoperating (Expense) Income, Net	(2.4)	(1.9)	0.5
Income Before Income Taxes	18.2	21.9	20

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Income Tax (Expense) Benefit, Net	(0.4)	1.3	0.3
Net Income	17.8%	23.2%	20.4%

Selected Statistical Information

Passengers carried (in thousands)	5,038	3,549	3,385
Occupancy percentage (b)	103.4%	105.2%	104.7%

(a) The information presented above includes the results of Carnival plc since April 17, 2003. See below for discussion of pro forma results.

(b) In accordance with cruise industry practice, occupancy percentage is calculated using a denominator of two passengers per cabin even though some cabins can accommodate three or more passengers. The percentages in excess of 100% indicate that more than two passengers occupied some cabins.

Fiscal 2003 ("2003") Compared To Fiscal 2002 ("2002")

Given that our reported results for 2003 include the results of Carnival plc for only the last seven and one-half months of 2003 and the preceding year does not include any of Carnival plc's results, we believe that the most meaningful presentation of our operating performance measures for 2003 is on a pro forma basis, which reflects the results of both Carnival Corporation and Carnival plc for the entirety of both years. Accordingly, we have disclosed pro forma information, as well as the required reported information, in the discussion of our results of operations.

Revenues

Cruise revenues increased $2.22 billion, or 52.2%, to $6.46 billion in 2003 from $4.24 billion in 2002. Approximately $1.75 billion of our cruise revenue increase was due to the consolidation of Carnival plc and $462 million (a 10.9% increase over 2002) was due to increased revenues from Carnival Corporation's cruise brands. Carnival Corporation's increase in cruise revenues resulted primarily from a 17.3% increase in its standalone ALBD capacity in 2003 compared to 2002, partially offset by lower cruise ticket prices and, to a lesser extent, a reduced number of passengers purchasing air transportation from Carnival Corporation.

Included in onboard and other revenues were concession revenues of $198 million in 2003 and $154 million in 2002.

Our pro forma ALBD capacity increase was 17.5% in 2003 compared to 2002. Pro forma gross revenue yields (gross revenue per ALBD) declined 3.8% (reported declined 2.1%) in 2003 compared to 2002 primarily for the same reasons as the decline in net revenue yields discussed below. Pro forma net revenue yields declined 3.2% (reported declined 3.4%) in 2003 compared to 2002 largely because of lower cruise ticket prices and, to a lesser extent, lower occupancy levels. Our revenue yields were adversely affected by consumer concerns about travel during the period leading up to the war with Iraq and its eventual outbreak, the uncertain world economy and the increase in cruise industry capacity. Finally, our pro forma net revenue yields in 2003 were favorably impacted by the strengthening of the euro and sterling against the dollar.

Other non-cruise revenues increased $169 million, or 96.0%, to $345 million in 2003 from $176 million in 2002 due to the consolidation of Princess Tours and P&O Travel Ltd.

Costs and Expenses

Total cruise operating expenses increased $1.40 billion, or 63.1%, to $3.62 billion in 2003 from $2.22 billion in 2002. Approximately $1.02 billion of our increase was due to the consolidation of Carnival plc, and the remaining $380 million (a 17.1% increase over 2002) of the increase was from Carnival Corporation. Carnival Corporation's increase was primarily a result of the impact of the 17.3% increase in its standalone ALBD capacity in 2003 compared to 2002. In addition, higher fuel prices added approximately $44 million to the Carnival Corporation standalone expenses in 2003 compared to 2002. Finally, the increase in each of the individual cruise operating expense line items was primarily a result of the same factors as discussed above. Pro forma cruise operating expenses increased $655 million, or 18.4%, to $4.2 billion in 2003 from $3.57 billion in 2002 primarily as a result of the 17.5% increase in pro forma ALBD capacity and higher fuel costs.

Other non-cruise operating expenses increased $135 million, or 93.1%, to $280 million in 2003 from $145 million in 2002 due to the consolidation of Princess Tours and P&O Travel Ltd.

Cruise selling and administrative expenses increased $319 million, or 55.3%, to $896 million in 2003 from $577 million in 2002. Approximately $247 million of our increase was due to the consolidation of Carnival plc and the remaining $72 million (a 12.5% increase over 2002) of the increase was from Carnival Corporation, which was primarily due to the 17.3% increase in standalone ALBD capacity. Pro forma cruise selling and administrative expenses, excluding Carnival plc nonrecurring DLC transaction expenses, increased $142 million, or 15.6%, to $1.05 billion from $912 million in 2002, primarily as a result of the 17.5% increase in pro forma ALBD capacity, partially offset by the benefits of scale and synergy savings from the DLC transaction.

Pro forma gross cruise costs per ALBD increased by 0.2% (reported increased 3.9%) in 2003 compared to 2002. Pro forma net cruise costs per ALBD

increased 2.9% (reported increased 4.0%) in 2003 compared to 2002. Pro forma gross and net cruise costs per ALBD in 2003 compared to 2002 were higher largely because of higher fuel costs. Finally, our pro forma net cruise costs were unfavorably affected by the weakening of the dollar against the euro and sterling.

Depreciation and amortization increased by $203 million, or 53.1%, to $585 million in 2003 from $382 million in 2002. A large portion of this increase was from the consolidation of Carnival plc, which accounted for approximately $126 million of the increase. The majority of the remaining increase was a result of the expansion of the Carnival Corporation fleet and ship improvement expenditures. Pro forma depreciation and amortization expense increased by $120 million, or 22.5%, to $654 million from $534 million largely due to the expansion of the combined fleet and ship improvement expenditures.

Nonoperating (Expense) Income

Interest expense, net of interest income and excluding capitalized interest, increased to $217 million in 2003 from $118 million in 2002, or $99 million, which increase was comprised primarily of a $125 million increase in interest expense from our increased level of average borrowings, partially offset by a $31 million decrease in interest expense due to lower average borrowing rates. The higher average debt balances were primarily a result of our consolidation of Carnival plc's debt (see Note 7 in the accompanying financial statements) and new ship deliveries. Capitalized interest increased $10 million during 2003 compared to 2002 due primarily to higher average levels of investments in ship construction projects.

Other income was $8 million in 2003, which included $19 million from net

insurance proceeds, $10 million as a result of Windstar's Wind Song casualty loss and $9 million as a reimbursement of expenses incurred in prior years, partially offset by $13 million related to a DLC-related litigation matter.

Income Taxes

The income tax provision of $29 million in 2003 was primarily due to the consolidation of Carnival plc's U.S. based Princess Tours and Costa's Italian taxable income.

Fiscal 2002 ("2002") Compared to Fiscal 2001 ("2001")

Revenues

Cruise revenues decreased $127 million, or 2.9%, to $4.24 billion in 2002 from $4.37 billion in 2001. Our cruise revenue change resulted from a 7.0% decrease in our gross revenue per passenger cruise day, partially offset by a 3.6% increase in passenger capacity and a 0.5% increase in our occupancy rate. This decrease in our gross revenue per passenger cruise day was primarily caused by a significant decline in the number of guests purchasing air transportation from us in 2002 compared to 2001. When a guest elects to provide his or her own transportation, rather than purchasing air transportation from us, both our cruise revenues and operating expenses decrease by approximately the same amount. Also adding to the reduction in gross revenue per passenger cruise day was the adverse impact of the September 11, 2001 events, which resulted in lower cruise ticket prices. Net revenue yield was down 2.7% (gross revenue yield was down 6.3%) in 2002 compared to 2001.

Included in onboard and other revenues were concession revenues of $154 million in 2002 and $136 million in 2001.

Other revenues, which consisted of Holland America Tours decreased $53 million, or 23.1%, to $176 million in 2002 from $229 million in 2001 principally due to a lower number of Alaska and Canadian Yukon cruise/tours

sold. This revenue decrease was primarily as a result of one less ship offering land tours to its guests in 2002 compared to 2001 and increased competition. In addition, three isolated cancellations of Holland America Alaska cruises in 2002 resulting primarily from mechanical malfunctions also contributed to this decrease in revenues.

Costs and Expenses

Total cruise operating costs decreased by $125 million, or 5.3%, to $2.22 billion in 2002 from $2.35 billion in 2001. Approximately $116 million of this decrease was due to reduced air travel and related costs primarily due to fewer guests purchasing air transportation through us, and $41 million was primarily due to lower commissions because of lower cruise revenues. This decrease was partially offset by an increase in fuel and other cruise operating expenses, which was largely due to costs associated with our 3.6% increase in passenger capacity. Net cruise operating costs per ALBD decreased 2.4% (gross cruise operating costs per ALBD decreased 7.8%), partially as a result of the cost reduction initiatives we undertook after the events of September 11, 2001.

Other operating expenses, which consisted of Holland America Tours, decreased $41 million, or 22.0%, to $145 million in 2002 from $186 million in 2001 principally due to the reduction in the number of cruise/tours sold.

Selling and administrative expenses decreased $10 million, or 1.6%, to $609 million in 2002 from $619 million in 2001. Selling and administrative expenses decreased in 2002 primarily because of our 4.7% decrease in cruise selling and administrative costs per ALBD, partially offset by additional expenses associated with our 3.6% increase in passenger capacity. Our costs per ALBD decreased partially because of the cost containment actions taken after September 11, 2001.

Depreciation and amortization increased by $10 million, or 2.7%, to $382 million in 2002 from $372 million in 2001. Depreciation and amortization

in 2002 compared to 2001 increased by $30 million primarily as a result of the expansion of our fleet and ship improvement expenditures, partially offset by the elimination of $20 million of annual goodwill amortization upon our adoption of SFAS No. 142 on December 1, 2001 (see Note 2 in the accompanying financial statements).

See Notes 5 and 6 in the accompanying financial statements for a discussion of the 2002 and 2001 impairment charge and 2001 affiliated operations.

Nonoperating (Expense) Income

Interest income decreased by $2 million in 2002 compared to 2001, which was comprised of a $25 million reduction in interest income due to lower average interest rates, partially offset by a $23 million increase in interest income from our higher average invested cash balances. Interest expense was the same in 2002 and in 2001, which was comprised of a $22 million increase in interest expense due to our increased level of average borrowings, offset by a $22 million reduction in interest expense due to lower average borrowing rates. The higher level of average borrowings in 2002 were due primarily from the issuance of our convertible notes in April and October 2001. Capitalized interest increased $10 million during 2002 compared to 2001 due primarily to higher average levels of investments in ship construction projects.

Other expense in 2002 of $4 million consisted primarily of a $8 million loss, including related expenses, resulting from the sale of Holland America Line's former Nieuw Amsterdam, partially offset by $4 million of income related to the termination of an over funded pension plan.

Income Taxes

The income tax benefit of $57 million recognized in 2002 was

substantially all due to an Italian investment incentive law, which allowed Costa to receive an income tax benefit of $51 million based on contractual expenditures during 2002 on the construction of a new ship.

Liquidity and Capital Resources

Sources and Uses of Cash

Our business provided $1.93 billion of net cash from operations during fiscal 2003, an increase of $464 million, or 31.6%, compared to fiscal 2002, due primarily to the consolidation of Carnival plc. We continue to generate substantial cash from operations and remain in a strong financial position.

During fiscal 2003, our net expenditures for capital projects were $2.52 billion, of which $2.25 billion was spent for our ongoing new shipbuilding program. The remaining capital expenditures consisted primarily of $133 million for ship improvements and refurbishments, and $130 million for Alaska tour assets, cruise port facility developments and information technology assets.

During fiscal 2003, we borrowed net proceeds of $1.08 billion primarily to finance a portion of our shipbuilding programs and other capital expenditures, and for working capital purposes. Specifically, we issued 1.75% Notes and 3.75% unsecured notes for gross proceeds of $1.12 billion, and we borrowed $335 million for the acquisition of the Island Princess. We also paid cash dividends of $292 million in fiscal 2003.

Future Commitments and Funding Sources

At November 30, 2003, our contractual cash obligations, with initial or remaining terms in excess of one year, and the effects such obligations are expected to have on our liquidity and cash flow in future periods were as follows (in millions):

Payments Due by Fiscal Year

Contractual Cash

Obligations (a)	Total	2004	2005	2006	2007	2008	Thereafter
Long-term debt	$ 7,310	$ 392	$1,263	$1,587	$ 999	$1,492	$1,577
Shipbuilding	4,994	2,982	1,237	775			
Port and other commitments	392	57	32	33	35	35	200
Operating leases	276	57	49	36	26	23	85
Total contractual cash obligations	$12,972	$3,488	$2,581	$2,431	$1,060	$1,550	$1,862

(a) See Notes 7, 8, 9 and 14 in the accompanying financial statements for additional information regarding our debt, shipbuilding and other contractual cash obligations and commitments and our contingent obligations.

At November 30, 2003, we had liquidity of $3.92 billion, which consisted of $1.07 billion of cash and cash equivalents, $2.11 billion available for borrowing under our $2.41 billion revolving credit facilities, and $736 million under committed ship financing arrangements. Our revolving credit facilities mature in September 2005 with respect to $710 million, and in May and June 2006 with respect to $1.70 billion. A key to our access to liquidity is the maintenance of our strong credit ratings.

We believe that our liquidity, including cash and committed financings, and cash flow from future operations will be sufficient to fund most of our expected capital projects, debt service requirements, dividend payments, working capital and other firm commitments. However, our forecasted cash flow

from future operations, as well as our credit ratings, may be adversely affected by various factors, including, but not limited to, those factors noted under "Cautionary Note Concerning Factors That May Affect Future Results." To the extent that we are required, or choose, to fund future cash requirements, including our future shipbuilding commitments, from sources other than as discussed above, we believe that we will be able to secure such financing from banks or through the offering of debt and/or equity securities in the public or private markets. No assurance can be given that our future operating cash flow will be sufficient to fund future obligations or that we will be able to obtain additional financing, if necessary.

Off-Balance Sheet Arrangements

We are not a party to any off-balance sheet arrangements, including guarantee contracts, retained or contingent interests, certain derivative instruments and variable interest entities, that either have, or are reasonably likely to have, a current or future material effect on our financial statements.

Other Matters

Market Risks

We are principally exposed to market risks from fluctuations in foreign currency exchange rates, bunker fuel prices and interest rates. We seek to minimize foreign currency and interest rate risks through our normal operating and financing activities, including netting certain exposures to take advantage of any natural offsets, through our long-term investment and debt portfolio strategies and, when considered appropriate, through the use of derivative financial instruments. The financial impacts of these hedging instruments are generally offset by corresponding changes in the underlying exposures being hedged. Our policy is to not use financial instruments for trading or other speculative purposes.

Exposure to Foreign Currency Exchange Rates

One of our primary foreign currency exchange risks is related to our

outstanding commitments under ship construction contracts denominated in a currency other than the functional currency of the cruise brand that is expected to be operating the ship. These currency commitments are affected by fluctuations in the value of the functional currency as compared to the currency in which the shipbuilding contract is denominated. Foreign currency forward contracts are generally used to manage this risk (see Notes 2, 8 and 12 in the accompanying financial statements). Accordingly, increases and decreases in the fair value of these foreign currency forward contracts offset changes in the fair value of the foreign currency denominated ship construction commitments, thus resulting in the elimination of such risk.

We have forward foreign currency contracts for seven of our euro denominated shipbuilding contracts. At November 30, 2003, the fair value of these forward contracts was an unrealized gain of $363 million which is recorded, along with an offsetting $363 million fair value liability related to our shipbuilding firm commitments, on our accompanying 2003 balance sheet. Based upon a 10% strengthening or weakening of the U.S. dollar compared to the euro as of November 30, 2003, assuming no changes in comparative interest rates, the estimated fair value of these contracts would decrease or increase by $247 million, which would be offset by a decrease or increase of $247 million in the U.S. dollar value of the related foreign currency ship construction commitments resulting in no net dollar impact to us.

The cost of shipbuilding orders that we may place in the future for our cruise lines who generate their cash flows in a currency that is different than the shipyard's operating currency, generally the euro, is expected to be affected by foreign currency exchange rate fluctuations. Given the recent decline in the U.S. dollar relative to the euro, the U.S. dollar cost to order

new cruise ships at current exchange rates has increased significantly. We currently have on order new cruise ships for delivery through 2006. Should the U.S. dollar remain at current levels or decline further, this may affect our ability to order new cruise ships for 2007 or later years.

In addition to the foreign currency denominated operations of our Costa subsidiary, we have broadened our global presence as a result of Carnival plc's foreign operations. Specifically, our expanded international business operations through P&O Cruises, Ocean Village and Swan Hellenic in the UK and Aida in Germany subject us to an increasing level of foreign currency exchange risk related to the sterling and euro. These are the primary currencies for which we have U.S. dollar exchange rate exposures. Accordingly, these foreign currency exchange fluctuations against the dollar will affect our reported financial results since the reporting currency for our consolidated financial statements is the U.S. dollar and the functional currency for our international operations is generally the local currency. Any weakening of the U.S. dollar against these local functional currencies has the financial statement effect of increasing the U.S. dollar values reported for cruise revenues and cruise expenses in our consolidated financial statements. Strengthening of the U.S. dollar has the opposite effect. We will continue to monitor the effect of such exposures to determine if any additional actions, such as the issuance of additional foreign currency denominated debt or use of other financial instruments would be warranted to reduce such risk.

We consider our investments in foreign subsidiaries to be denominated in relatively stable currencies and/or of a long-term nature. However, we partially hedge these exposures by denominating our debt in our subsidiary's

functional currency (generally euros or sterling). Specifically, we have $ 815 million of cross currency swaps, whereby we have converted U.S. dollar debt to euro and sterling debt and euro debt to sterling debt, thus partially offsetting this foreign currency exchange risk. At November 30, 2003, the fair value of these cross currency swaps was a loss of $70 million, $39 million of which is recorded in AOCI and offsets a portion of the gains recorded in AOCI upon translating these foreign subsidiaries net assets into U.S. dollars. Based upon a 10% hypothetical increase or decrease in the November 30, 2003 foreign currency exchange rate, we estimate that these contracts fair values would increase or decrease by $82 million, which would be offset by a decrease or increase of $82 million in the U.S. dollar value of our net investments.

Exposure to Bunker Fuel Prices

Other cruise ship operating expenses are impacted by changes in bunker fuel prices. Fuel consumed over the past three fiscal years ranged from approximately 5.5% in fiscal 2003 to 4.5% in fiscal 2002 and 4.2% in fiscal 2001 of our cruise revenues. We have typically not used financial instruments to hedge our exposure to the bunker fuel price market risk.

Based upon a 10% hypothetical increase or decrease in the November 30, 2003 bunker fuel price, we estimate that our fiscal 2004 bunker fuel cost would increase or decrease by approximately $45 million.

Exposure to Interest Rates

In order to limit our exposure to interest rate fluctuations, we have entered into a substantial number of fixed rate debt instruments. We continuously evaluate our debt portfolio, including interest rate swap agreements, and make periodic adjustments to the mix of floating rate and fixed rate debt based on our view of interest rate movements. Accordingly in 2003 and 2001, we entered into fixed to variable interest rate swap agreements, which lowered our fiscal 2003, 2002 and 2001 interest costs and are also expected to lower our fiscal 2004 interest costs. At November 30,

2003, 61% of the interest cost on our debt was effectively fixed and 39% was variable, including the effect of our interest rate swaps.

At November 30, 2003, our long-term debt had a carrying value of $7.31 billion. At November 30, 2003, our interest rate swap agreements effectively changed $1.19 billion of fixed rate debt to Libor-based floating rate debt. In addition, interest rate swaps at November 30, 2003 effectively changed $760 million of euribor floating rate debt to fixed rate debt. The fair value of our long-term debt and interest rate swaps at November 30, 2003 was $7.69 billion. Based upon a hypothetical 10% decrease or increase in the November 30, 2003 market interest rates, the fair value of our long-term debt and swaps would increase or decrease by $128 million. In addition, based upon a hypothetical 10% decrease or increase in our November 30, 2003 common stock price, the fair value of our convertible notes would increase or decrease by approximately $97 million.

These hypothetical amounts are determined by considering the impact of the hypothetical interest rates and common stock price on our existing long-term debt and interest rate swaps. This analysis does not consider the effects of the changes in the level of overall economic activity that could exist in such environments or any relationships which may exist between interest rate and stock price movements. Furthermore, since substantially all of our fixed rate long-term debt cannot currently be called or prepaid and some of our variable rate long-term debt is subject to interest rate swaps which effectively fix the interest rate, it is unlikely we would be able to take any significant steps in the short-term to mitigate our exposure in the unlikely event of a significant decrease in market interest rates.

REPORTED GAAP RECONCILING INFORMATION

Gross and net revenue yields were computed as follows:

	Years Ended November 30,		
	2003	2002	2001
	(in millions, except ALBDs and yields)		
Cruise revenues			
Passenger tickets	$5,039	$3,346	$3,530
Onboard and other	1,420	898	841
Gross cruise revenues	6,459	4,244	4,371
Less cruise costs			
Passenger tickets	(1,021)	(658)	(813)
Onboard and other	(229)	(116)	(116)
Net cruise revenues	$5,209	$3,470	$3,442
ALBDs(a)	33,309,785	21,435,828	20,685,123
Gross revenue yields (b)	$193.91	$198.01	$211.33
Net revenue yields (c)	$156.38	$161.91	$166.44

Gross and net cruise costs per ALBD were computed as follows:

	Years Ended November 30,		
	2003	2002	2001
	(in millions, except ALBDs and costs per ALBD)		
Cruise operating expenses	$3,624	$2,222	$2,347
Cruise selling and administrative expenses	896	577	584
Gross cruise costs	4,520	2,799	2,931
Less cruise costs			
Passenger tickets	(1,021)	(658)	(813)
Onboard and other	(229)	(116)	(116)
Net cruise costs	$3,270	$2,025	$2,002
ALBDs(a)	33,309,785	21,435,828	20,685,123
Gross cruise costs per ALBD (d)	$135.69	$130.54	$141.66
Net cruise costs per ALBD (e)	$98.16	$94.43	$96.76

PRO FORMA GAAP RECONCILING INFORMATION

Pro forma gross and net revenue yields, assuming that the DLC transaction was completed and Carnival plc was consolidated for the full years noted below, would have been computed as follows (f):

	Years Ended November 30, 2003	2002
	(in millions, except ALBDs and yields)	
Cruise revenues		
Passenger tickets	$5,732	$5,128
Onboard and other	1,600	1,356
Gross cruise revenues	7,332	6,484
Less cruise costs		
Passenger tickets	(1,227)	(1,121)
Onboard and other	(279)	(240)
Net cruise revenues	$5,826	$5,123
ALBDs (a)	37,554,709	31,962,000
Gross revenue yields (b)	$195.23	$202.85
Net revenue yields (c)	$155.11	$160.25

Pro forma gross and net cruise costs per ALBD would have been computed as follows (f):

Years Ended November 30,

	2003	2002
	(in millions, except ALBDs and costs per ALBD)	
Cruise operating expenses	$4,222	$3,567
Cruise selling and administrative expenses	1,054	912
Gross cruise costs	5,276	4,479
Less cruise costs		
Passenger tickets	(1,227)	(1,121)
Onboard and other	(279)	(240)
Net cruise costs	$3,770	$3,118
ALBDs(a)	37,554,709	31,962,000
Gross cruise costs per ALBD (d)	$140.50	$140.15
Net cruise costs per ALBD (e)	$100.38	$97.55

(a) Total passenger capacity for the period, assuming two passengers per cabin, that we offer for sale, which is computed by multiplying passenger capacity by revenue-producing ship operating days in the period.

(b) Gross cruise revenues divided by ALBDs.

(c) Net cruise revenues divided by ALBDs.

(d) Gross cruise costs divided by ALBDs.

(e) Net cruise costs divided by ALBDs.

(f) The pro forma information gives pro forma effect for the DLC transaction between Carnival Corporation and Carnival plc, which was completed on April 17, 2003, as if the DLC transaction had occurred on December 1, 2001. Management has prepared the pro forma information based upon the

companies' reported financial information and, accordingly, the above information should be read in conjunction with the companies' financial statements.

The DLC transaction has been accounted for as an acquisition of Carnival plc by Carnival Corporation, using the purchase method of accounting. The Carnival plc accounting policies have been conformed to Carnival Corporation's policies. Carnival plc's reporting period has been changed to the Carnival Corporation reporting period and the information presented above covers the same periods of time for both companies.

The above pro forma information has not been adjusted to reflect any net transaction benefits from the DLC transaction. In addition, it excludes the costs related to the terminated Royal Caribbean transaction and the completion of the DLC transaction with Carnival Corporation, which were expensed by Carnival plc prior to April 17, 2003. The exclusion of these nonrecurring costs is consistent with the requirements of Article 11 of Regulation S-X. Finally, the pro forma information does not purport to represent what the results of operations actually could have been if the DLC transaction had occurred on December 1, 2001 or what those results will be for any future periods.

The 2003 pro forma information is computed by adding four and one-half months of Carnival plc's results of operations, adjusted for SFAS No. 141 acquisition accounting adjustments, to the reported Carnival Corporation & plc results since the April 17, 2003 DLC transaction date.

The 2002 pro forma information is computed by adding Carnival plc's 2002 results, adjusted for acquisition adjustments, to the 2002 Carnival Corporation reported results. For additional information related to the pro forma statements of operations see Note 3 in the accompanying

financial statements.

(g) We have not provided estimates of future gross revenue yields or gross cruise costs per ALBD because we are unable to provide reconciliations of forecasted net cruise revenues to forecasted gross cruise revenues or forecasted net cruise costs to forecasted cruise operating expenses without unreasonable effort. The reconciliations would require us to forecast, with reasonable accuracy, the amount of air and other transportation costs that our forecasted cruise passengers would elect to purchase from us (the "air/sea mix"). Since the forecasting of future air/sea mix involves several significant variables and the revenues from the sale of air and other transportation approximate the costs of providing that transportation, management focuses primarily on forecasts of net cruise revenues and costs rather than gross cruise revenues and costs. This does not impact, in any material respect, our ability to forecast our future results, as any variation in the air/sea mix has no material impact on our forecasted net cruise revenues or forecasted net cruise costs.

SCHEDULE B

CARNIVAL CORPORATION & PLC - U.S. GAAP CONSOLIDATED FINANCIAL STATEMENTS

CARNIVAL CORPORATION & PLC
CONSOLIDATED STATEMENTS OF OPERATIONS
(in millions, except per share data)

	Years Ended November 30,		
	2003	2002	2001
Revenues			
Cruise			
Passenger tickets	$5,039	$3,346	$3,

			530
Onboard and other	1,420	898	841
Other	259	139	178
	------	------	------
	6,718	4,383	4,549
	------	------	------
Costs and Expenses			
Operating			
Cruise			
Passenger tickets	1,021	658	813
Onboard and other	229	116	116
Payroll and related	744	458	459
Food	393	256	265
Other ship operating	1,237	734	694
Other	194	108	135
	------	------	------
Total	3,818	2,330	2,482
Selling and administrative	932	609	619
Depreciation and amortization	585	382	372
Impairment charge		20	140
Loss from affiliated operations, net			44
	------	------	------
	5,335	3,341	3,657

Operating Income	1,383	1,042	892
Nonoperating (Expense) Income			
Interest income	27	32	34
Interest expense, net of capitalized interest	(195)	(111)	(121)
Other income (expense), net	8	(4)	109
	(160)	(83)	22
Income Before Income Taxes	1,223	959	914
Income Tax (Expense) Benefit, Net	(29)	57	12
Net Income	$1,194	$1,016	$ 926
Earnings Per Share			
Basic	$1.66	$1.73	$1.58
Diluted	$1.66	$1.73	$1.58

===

Dividends Per Share	$0.44	$0.42	$0.42
	======	======	======

The accompanying notes are an integral part of these consolidated financial statements.

CARNIVAL CORPORATION & PLC
CONSOLIDATED BALANCE SHEETS
(in millions, except par/stated values)

	November 30,	
ASSETS	2003	2002
Current Assets		
Cash and cash equivalents	$ 1,070	$ 667
Short-term investments	1	39
Accounts receivable, net	403	108
Inventories	171	91
Prepaid expenses and other	212	149
Fair value of derivative contracts	275	
Fair value of hedged firm commitments		78
Total current assets	2,132	1,132
Property and Equipment, Net	17,522	10,116
Goodwill	3,031	

```
681
     Trademarks                                                    1,324

Other Assets                                                  345
297
     Fair Value of Derivative Contracts                             135

Fair Value of Hedged Firm Commitments                           2
109

                                                           -------       ----
---

                                                           $24,491       $12,
335

                                                           =======       ====
===

     LIABILITIES AND SHAREHOLDERS' EQUITY
     Current Liabilities
       Short-term borrowings                                 $    94

  Current portion of long-term debt                           392       $
155

  Accounts payable                                            645
269

  Accrued liabilities                                         441
290

  Customer deposits                                         1,352
771

  Dividends payable                                           100
 61
       Fair value of hedged firm commitments                        264

  Fair value of derivative contracts                           27
 74

                                                           -------       ----
---

    Total current liabilities                               3,315          1,
620

                                                           -------       ----
---


Long-Term Debt                                              6,918          3,
014

Deferred Income and Other Long-Term Liabilities               299
170
     Fair Value of Hedged Firm Commitments                          103

Fair Value of Derivative Contracts                             63
113
```

Commitments and Contingencies (Notes 8, 9 and 14)		
Shareholders' Equity		
Common stock of Carnival Corporation; $.01 par value; 1,960 shares at 2003 and 960 at 2002 authorized; 630 shares at 2003 and 587 shares at 2002 issued and outstanding	6	6
Ordinary shares of Carnival plc; $1.66 stated value; 226 shares authorized; 210 shares issued	349	
Additional paid-in capital	7,163	1,089
Retained earnings	7,191	6,326
Unearned stock compensation	(18)	(11)
Accumulated other comprehensive income	160	8
Treasury stock; 42 shares of Carnival plc at cost	(1,058)	
Total shareholders' equity	13,793	7,418
	$24,491	$12,335

The accompanying notes are an integral part of these consolidated financial statements.

CARNIVAL CORPORATION & PLC
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in millions)

	Years Ended November 30,		
	2003	2002	2001
OPERATING ACTIVITIES			

Net income	$1,194	$1,016	$ 926
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	585	382	372
Impairment charge		20	140
Gain on sale of investments in affiliates, net			(117)
Loss from affiliated operations and dividends received			57
Accretion of original issue discount	20	19	2
Other	8	14	19
Changes in operating assets and liabilities, excluding business acquired			
(Increase) decrease in			
Receivables	(91)	(5)	(7)
Inventories	(17)	2	9
Prepaid expenses and other	82	(81)	44
Increase (decrease) in			
Accounts payable	43	(12)	(63)
Accrued and other liabilities	(16)	(28)	
Customer deposits	125	142	(143)
	------	------	------
Net cash provided by operating activities	1,933	1,469	1,239
	------	------	------
INVESTING ACTIVITIES			
Additions to property and equipment	(2,516)	(1,986)	(827)
Proceeds from sale of investments in affiliates			531
Cash acquired from (expended for) the acquisition			

of Carnival plc, net	140	(30)	
Proceeds from retirement of property and equipment	51	4	15
Sale (purchase) of short-term investments, net	42	2	(33)
Other, net	(50)	(10)	(28)
Net cash used in investing activities	(2,333)	(2,020)	(342)
FINANCING ACTIVITIES			
Proceeds from issuance of long-term debt	2,123	232	2,574
Principal repayments of long-term debt	(1,137)	(190)	(1,971)
Dividends paid	(292)	(246)	(246)
Proceeds from short-term borrowings, net	94		
Proceeds from issuance of common stock and ordinary shares	53	7	5
Other	(15)	(1)	(25)
Net cash provided by (used in) financing activities	826	(198)	337
Effect of exchange rate changes on cash and cash equivalents	(23)	(5)	(2)
Net increase (decrease) in cash and cash equivalents	403	(754)	1,232
Cash and cash equivalents at beginning of year	667	1,421	189

	------	------	------
Cash and cash equivalents at end of year	$1,070	$ 667	$1,421
	======	======	======

The accompanying notes are an integral part of these consolidated financial statements.

CARNIVAL CORPORATION & PLC
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(in millions)

	Comprehensive income	Common stock	Ordinary shares	Additional paid-in capital	Retained earnings
Balances at November 30, 2000		$6		$1,773	$4,884
Comprehensive income					
Net income	$ 926				926
Foreign currency translation adjustment, net	46				
Unrealized gains on marketable securities, net	6				
Minimum pension liability adjustment	(6)				
Changes related to cash flow derivative hedges, net	(4)				
Transition adjustment for cash flow derivative hedges	(4)				

Total comprehensive income	$ 964				
	======				
Cash dividends declared					(246)
Issuance of stock under stock plans				32	
Amortization of unearned stock compensation					
Other					(8)

Balances at November 30, 2001		6		1,805	5,556
Comprehensive income					
Net income	$1,016				1,016
Foreign currency translation adjustment	51				
Minimum pension liability adjustment	(9)				
Unrealized gains on marketable securities, net	3				
Total comprehensive income	$1,061				
Cash dividends declared					(246)
Issuance of stock under stock plans				11	
Retirement of treasury stock				(727)	
Amortization of unearned stock compensation					
Balances at November 30, 2002		6		1,089	6,326
Comprehensive income					
Net income	$1,194				1,194
Foreign currency translation adjustment	162				
Unrealized losses on marketable securities, net	(1)				
Changes related to cash flow derivative hedges, net	(9)				
Total comprehensive income	$1,346				
Cash dividends declared					(329)
Acquisition of Carnival plc			$346	6,010	
Issuance of stock under stock plans			3	64	
Amortization of unearned stock compensation					
Balances at November 30, 2003		$ 6	$349	$7,163	$7,191

	Unearned stock compen-sation	Accumulated other comprehensive income (loss)	Treasury stock	Total share-holders equity
Balances at November 30, 2000	$(12)	$(75)	$(705)	$5,871
Comprehensive income				
Net income				926
Foreign currency translation adjustment, net		46		46
Unrealized gains on marketable securities, net		6		6
Minimum pension liability adjustment		(6)		(6)
Changes related to cash flow derivative hedges, net		(4)		(4)
Transition adjustment for cash flow derivative hedges		(4)		(4)
Total comprehensive income				
Cash dividends declared				(246)
Issuance of stock under stock plans	(5)		(22)	5
Amortization of unearned stock compensation	5			5
Other				(8)
	------	------	-------	------

Balances at November 30, 2001	(12)	(37)	(727)	6,591
Comprehensive income				
Net income				1,016
Foreign currency translation adjustment		51		51
Minimum pension liability adjustment		(9)		(9)
Unrealized gains on marketable securities, net		3		3
Total comprehensive income				
Cash dividends declared				(246)
Issuance of stock under stock plans	(4)			7
Retirement of treasury stock			727	
Amortization of unearned stock compensation	5			5
	------	------	-------	------
Balances at November 30, 2002	(11)	8		7,418
Comprehensive income				
Net income				1,194
Foreign currency translation adjustment		162		162
Unrealized losses on marketable securities, net		(1)		(1)
Changes related to cash flow derivative hedges, net		(9)		(9)
Total comprehensive income				
Cash dividends declared				(329)
Acquisition of Carnival plc			(1,058)	5,298
Issuance of stock under				

stock plans	(14)			53
Amortization of unearned stock compensation	7			7
	------	------	-------	-------
Balances at November 30, 2003	$(18)	$ 160	$(1,058)	$13,793
	======	======	=======	=======

The accompanying notes are an integral part of these consolidated financial statements.

CARNIVAL CORPORATION & PLC
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - General

Description of Business

On April 17, 2003, Carnival Corporation and Carnival plc (formerly known as P&O Princess Cruises plc) completed a dual listed company ("DLC") transaction (the "DLC transaction"), which implemented Carnival Corporation & plc's DLC structure. The DLC transaction combined the businesses of Carnival Corporation and Carnival plc through a number of contracts and amendments to Carnival Corporation's articles of incorporation and by-laws and to Carnival plc's memorandum of association and articles of association. The two companies have retained their separate legal identities, and each company's shares continue to be publicly traded on the New York Stock Exchange ("NYSE") for Carnival Corporation and the London Stock Exchange for Carnival plc. In addition, Carnival plc ADS's are traded on the NYSE. However, the two companies operate as if they were a single economic enterprise (see Note 3).

Carnival Corporation is a Panamanian corporation and Carnival plc is incorporated in England and Wales. Together with their consolidated

subsidiaries they are referred to collectively in these consolidated financial statements and elsewhere in this 2003 Annual Report as "Carnival Corporation & plc," "our," "us," and "we." Our consolidated financial statements include the consolidated results of operations of Carnival Corporation for all periods presented and Carnival plc's consolidated results of operations since April 17, 2003.

We are a global cruise company and one of the largest vacation companies in the world. As of February 15, 2004, a summary of the number of cruise ships we operate, by brand, their passenger capacity and the primary areas in which they are marketed is as follows:

Cruise Brands	Number of Cruise Ships	Passenger Capacity (a)	Primary Market
Carnival Cruise Lines ("CCL")	20	43,446	North America
Princess Cruises ("Princess")	11	19,880	North America
Holland America Line	12	16,320	North America
Costa Cruises ("Costa")	10	15,570	Europe
P&O Cruises	4	7,724	United Kingdom
AIDA	4	5,314	Germany
Cunard Line ("Cunard")	3	5,078	United Kingdom/ North America
Ocean Village	1	1,602	United Kingdom
P&O Cruises Australia	1	1,200	Australia
Swan Hellenic	1	678	United Kingdom
Seabourn Cruise Line ("Seabourn")	3	624	North America
Windstar Cruises ("Windstar")	3	604	North America
	73	118,040	

(a) In accordance with cruise industry practice, passenger capacity is calculated based on two passengers per cabin even though some cabins can accommodate three or more passengers.

Preparation of Financial Statements

The preparation of our consolidated financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported and disclosed in our financial statements. Actual results could differ from these estimates. All material intercompany accounts, transactions and unrealized profits and losses on transactions within our consolidated group and with affiliates are eliminated in consolidation.

Commencing in 2003, we changed the reporting format of our consolidated statements of operations to present our significant revenue sources and their directly related variable costs and expenses. In addition, we have separately identified certain ship operating expenses, such as payroll and related expenses and food costs. All prior periods were reclassified to conform to the current year presentation.

NOTE 2 - Summary of Significant Accounting Policies

Basis of Presentation

We consolidate entities over which we have control, as typically evidenced by a direct ownership interest of greater than 50%. For affiliates where significant influence over financial and operating policies exists, as typically evidenced by a direct ownership interest from 20% to 50%, the investment is accounted for using the equity method. See Note 6.

Cash and Cash Equivalents and Short-Term Investments

Cash and cash equivalents include investments with original maturities of three months or less, which are stated at cost. At November 30, 2003 and 2002, cash and cash equivalents included $937 million and $616 million of

investments, respectively, primarily comprised of strong investment grade asset-backed **debt obligations**, commercial paper and money market funds.

Short-term investments are comprised of marketable debt and equity securities which are categorized as available for sale and, accordingly, are stated at their fair values. Unrealized gains and losses are included as a component of accumulated other comprehensive income ("AOCI") within shareholders' equity until realized. The specific identification method is used to determine realized gains or losses.

Inventories

Inventories consist primarily of provisions, gift shop and art merchandise held for resale, spare parts, supplies and fuel carried at the lower of cost or market. Cost is determined using the weighted average or first-in, first-out methods.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization were computed using the straight-line method over our estimates of average useful lives and residual values, as a percentage of original cost, as follows:

	Residual Values	Years
Ships	15%	30
Buildings and improvements	0-10%	5-40
Transportation equipment and other	0-25%	2-20
Leasehold improvements, including port facilities		Shorter of lease term or related asset life

We review our long-lived assets for impairment whenever events or changes

in circumstances indicate that the carrying amount of these assets may not be fully recoverable. The assessment of possible impairment is based on our ability to recover the carrying value of our asset based on our estimate of its undiscounted future cash flows. If these estimated undiscounted future cash flows are less than the carrying value of the asset, an impairment charge is recognized for the excess, if any, of the assets carrying value over itsestimated fair value (see Note 5).

Dry-dock costs are included in prepaid expenses and are amortized to other ship operating expenses using the straight-line method generally over one year.

Ship improvement costs that we believe add value to our ships are capitalized to the ships, and depreciated over the improvements' estimated useful lives, while costs of repairs and maintenance are charged to expense as incurred. We capitalize interest on ships and other capital projects during their construction period. Upon the replacement or refurbishment of previously capitalized ship components, these assets' estimated cost and accumulated depreciation are written-off and any resulting loss is recognized in our results of operations. No such material losses were recognized in fiscal 2003, 2002 or 2001. See Note 4.

Goodwill

Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" requires companies to stop amortizing goodwill and requires an annual, or when events or circumstances dictate, a more frequent, impairment review of goodwill. Accordingly, upon adoption of SFAS No. 142 on December 1, 2001, we ceased amortizing our goodwill, all of which had been allocated to our cruise reporting units. In April 2003, we recorded $2.25 billion of additional goodwill as a result of our acquisition of Carnival plc, which was also allocated to our cruise reporting units (see Note 3). There was no other change to our goodwill carrying amount since November

30, 2001, other than the changes resulting from using different foreign currency translation rates at each balance sheet date.

The SFAS No. 142 goodwill impairment review consists of a two-step process of first determining the fair value of the reporting unit and comparing it to the carrying value of the net assets allocated to the reporting unit. Fair values of our reporting units were determined based on our estimates of comparable market price or discounted future cash flows. If this fair value exceeds the carrying value, which was the case for our reporting units, no further analysis or goodwill write-down is required. If the fair value of the reporting unit is less than the carrying value of the net assets, the implied fair value of the reporting unit is allocated to all the underlying assets and liabilities, including both recognized and unrecognized tangible and intangible assets, based on their fair value. If necessary, goodwill is then written-down to its implied fair value.

Prior to fiscal 2002, our goodwill was reviewed for impairment pursuant to the same policy as our other long-lived assets as discussed above (see Note 5) and our goodwill was amortized over 40 years using the straight-line method.

If goodwill amortization, including goodwill expensed as part of our loss from affiliated operations, had not been recorded for fiscal 2001 our adjusted net income would have been $952 million and our adjusted basic and diluted earnings per share would have been $1.63 and $1.62, respectively.

Trademarks

The cost of developing and maintaining our trademarks have been expensed as incurred. However, pursuant to SFAS No. 141, "Business Combinations," commencing for acquisitions made after June 2001, we have allocated a portion of the purchase price to the acquiree's identified trademarks. The trademarks

that Carnival Corporation recorded as part of the DLC transaction, which are estimated to have an indefinite useful life and, therefore, are not amortizable, are reviewed for impairment annually, or more frequently when events or circumstances indicate that the trademark may be impaired. Our trademarks are considered impaired if their carrying value exceeds their fair value. See Note 3.

Derivative Instruments and Hedging Activities

We utilize derivative and nonderivative financial instruments, such as forward foreign currency contracts, cross currency swaps and foreign currency **debt obligations** to limit our exposure to fluctuations in foreign currency exchange rates and interest rate swaps to manage our interest rate exposure and to achieve a desired proportion of variable and fixed rate debt (see Note 12).

All derivatives are recorded at fair value, and the changes in fair value must be immediately included in earnings if the derivatives do not qualify as effective hedges. If a derivative is a fair value hedge, then changes in the fair value of the derivative are offset against the changes in the fair value of the underlying hedged firm commitment. If a derivative is a cash flow hedge, then changes in the fair value of the derivative are recognized as a component of AOCI until the underlying hedged item is recognized in earnings. If a derivative or a nonderivative financial instrument is designated as a hedge of a net investment in a foreign operation, then changes in the fair value of the financial instrument are recognized as a component of AOCI to immediately offset the change in the translated value of the net investment being hedged, until the investment is liquidated.

The ineffective portion of a hedge's change in fair value is immediately recognized in earnings. We formally document all relationships between hedg

ing instruments and hedged items, as well as our risk management objectives and strategies for undertaking our hedge transactions.

We classify the fair value of our derivative contracts and the fair value of our offsetting hedged firm commitments as either current or long-term assets and liabilities depending on whether the maturity date of the derivative contract is within or beyond one year from our balance sheet dates, respectively. The cash flows from derivatives treated as hedges are classified in our statements of cash flows in the same category as the item being hedged.

During fiscal 2003, 2002 and 2001, all net changes in the fair value of both our fair value hedges and the offsetting hedged firm commitments and our cash flow hedges were immaterial, as were any ineffective portions of these hedges. No fair value hedges or cash flow hedges were derecognized or discontinued in fiscal 2003, 2002 or 2001, and the amount of estimated cash flow hedges unrealized net losses which are expected to be reclassified to earnings in the next twelve months is not material. At November 30, 2003 and 2002, AOCI included $17 million and $8 million of unrealized net losses, respectively, from cash flow hedge derivatives, the majority of which were variable to fixed interest rate swap agreements.

Finally, if any shipyard with which we have contracts to build our ships is unable to perform, we would be required to perform under our foreign currency forward contracts related to these shipbuilding contracts. Accordingly, based upon the circumstances, we may have to discontinue the accounting for those forward contracts as hedges, if the shipyard cannot perform. However, we believe that the risk of shipyard nonperformance is remote.

Revenue and Expense Recognition

Guest cruise deposits represent unearned revenues and are initially recorded as customer deposit liabilities when received. Customer deposits are

subsequently recognized as cruise revenues, together with revenues from onboard and other activities and all associated direct costs of a voyage, generally upon completion of voyages with durations of ten days or less and on a pro rata basis for voyages in excess of ten days. Future travel discount vouchers issued to guests are recorded as a reduction of revenues when such vouchers are utilized. Revenues and expenses from our tour and travel services are recognized at the time the services are performed or expenses are incurred.

Advertising Costs

Substantially all of our advertising costs are charged to expense as incurred, except costs which result in tangible assets, such as brochures, which are recorded as prepaid expenses and charged to expense as consumed. Media production costs are also recorded as prepaid expenses and charged to expense upon the first airing of the advertisement. Advertising expenses totaled $334 million, $208 million and $214 million in fiscal 2003, 2002 and 2001, respectively. At November 30, 2003 and 2002, the amount of advertising costs included in prepaid expenses was not material.

Foreign Currency Translations and Transactions

For our foreign subsidiaries and affiliates using the local currency as their functional currency, assets and liabilities are translated at exchange rates in effect at the balance sheet dates. Translation adjustments resulting from this process are reported as cumulative translation adjustments, which are a component of AOCI. Revenues and expenses of these foreign subsidiaries and affiliates are translated at weighted-average exchange rates for the period. Therefore, the U.S. dollar value of these items on the income statement fluctuates from period to period, depending on the value of the dollar against these functional currencies. Exchange gains and losses arising

from transactions denominated in a currency other than the functional currency of the entity involved are immediately included in our earnings.

Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock and ordinary shares outstanding during each period. Diluted earnings per share is computed by dividing adjusted net income by the weighted-average number of shares of common stock and ordinary shares, common stock equivalents and other potentially dilutive securities outstanding during each period. See Note 15.

Stock-Based Compensation

Pursuant to SFAS No. 123, "Accounting for Stock-Based Compensation," as amended, we elected to use the intrinsic value method of accounting for our employee and director stock-based compensation awards. Accordingly, we have not recognized compensation expense for our noncompensatory employee and director stock option awards. Our adjusted net income and adjusted earnings per share, had we elected to adopt the fair value approach of SFAS No. 123, which charges earnings for the estimated fair value of stock options, would have been as follows (in millions, except per share amounts):

	Years ended November 30,		
	2003	2002	2001
Net income, as reported	$1,194	$1,016	$926
Stock-based compensation expense included in net income, as reported	7	5	5
Total stock-based compensation expense determined under the fair value-based			

method for all awards	(36)	(30)	(27)
Adjusted net income for basic earnings per share	1,165	991	904
Interest on dilutive convertible notes	5		
Adjusted net income for diluted earnings per share	$1,170	$991	$904
Earnings per share			
Basic			
As reported	$ 1.66	$ 1.73	$ 1.58
Adjusted	$ 1.62	$ 1.69	$ 1.54
Diluted			
As reported	$ 1.66	$ 1.73	$ 1.58
Adjusted	$ 1.62	$ 1.69	$ 1.54

As recommended by SFAS No. 123, the fair value of options were estimated using the Black-Scholes option-pricing model. The Black-Scholes weighted-average assumptions were as follows:

Fair value of options at the dates of grant	$13.33	$12.16	$12.67

Risk free interest rates	3.5%	4.3%	4.5%
Dividend yields	1.30%	1.23%	1.16%
Expected volatility	48.7%	48.0%	50.0%
Expected option life (in years)	6	6	6

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting or trading restrictions and are fully transferable. In addition, option-pricing models require the input of subjective assumptions, including expected stock price volatility. Because our options have characteristics different from those of traded options, the existing models do not necessarily provide a reliable single measure of the fair value of our options.

Concentrations of Credit Risk

As part of our ongoing control procedures, we monitor concentrations of credit risk associated with financial and other institutions with which we conduct significant business. Credit risk, including counterparty nonperformance under derivative instruments, contingent obligations and new ship progress payment guarantees, is considered minimal, as we primarily conduct business with large, well-established financial institutions who have long-term credit ratings of A or above and we seek to diversify our counterparties. In addition, we have established guidelines regarding credit ratings and investment maturities that we follow to maintain safety and

liquidity. We do not anticipate nonperformance by any of our significant counterparties.

We also monitor the creditworthiness of our customers to which we grant credit terms in the normal course of our business. Concentrations of credit risk associated with these receivables are considered minimal primarily due to their short maturities and large number of accounts within our customer base. We have experienced only minimal credit losses on our trade receivables. We do not normally require collateral or other security to support normal credit sales. However, we do normally require collateral and/or guarantees to support notes receivable on significant asset sales and new ship progress payments to shipyards.

Reclassifications

Reclassifications have been made to prior year amounts to conform to the current year presentation.

NOTE 3 - DLC Transaction

The contracts governing the DLC structure provide that Carnival Corporation and Carnival plc each continue to have separate boards of directors, but the boards and senior executive management of both companies are identical. The amendments to the constituent documents of each of the companies also provide that, on most matters, the holders of the common equity of both companies effectively vote as a single body. On specified matters where the interests of Carnival Corporation's shareholders may differ from the interests of Carnival plc's shareholders (a "class rights action"), each shareholder body will vote separately as a class, such as transactions primarily designed to amend or unwind the DLC structure. Generally, no class rights action will be implemented unless approved by both shareholder bodies.

Upon the closing of the DLC transaction, Carnival Corporation and

Carnival plc also executed the Equalization and Governance Agreement, which provides for the equalization of dividends and liquidation distributions based on an equalization ratio and contains provisions relating to the governance of the DLC structure. Because the current equalization ratio is 1 to 1, one Carnival plc ordinary share is entitled to the same distributions, subject to the terms of the Equalization and Governance Agreement, as one share of Carnival Corporation common stock. In a liquidation of either company or both companies, if the hypothetical potential per share liquidation distributions to each company's shareholders are not equivalent, taking into account the relative value of the two companies' assets and the indebtedness of each company, to the extent that one company has greater net assets so that any liquidation distribution to its shareholders would not be equivalent on a per share basis, the company with the ability to make a higher net distribution is required to make a payment to the other company to equalize the possible net distribution to shareholders, subject to certain exceptions.

At the closing of the DLC transaction, Carnival Corporation and Carnival plc also executed deeds of guarantee. Under the terms of Carnival Corporation's deed of guarantee, Carnival Corporation has agreed to guarantee all indebtedness and certain other monetary obligations of Carnival plc that are incurred under agreements entered into on or after the closing date of the DLC transaction. The terms of Carnival plc's deed of guarantee are identical to those of Carnival Corporation's. In addition, Carnival Corporation and Carnival plc have each extended their respective deeds of guarantee to the other's pre-DLC indebtedness and other monetary obligations, thus effectively

cross guaranteeing all Carnival Corporation and Carnival plc indebtedness and other monetary obligations. Each deed of guarantee provides that the creditors to whom the obligations are owed are intended third party beneficiaries of such deed of guarantee.

The deeds of guarantee are governed and construed in accordance with the laws of the Isle of Man. Subject to the terms of the guarantees, the holders of indebtedness and other obligations that are subject to the guarantees will have recourse to both Carnival plc and Carnival Corporation though a Carnival plc creditor must first make written demand on Carnival plc and a Carnival Corporation creditor on Carnival Corporation. Once the written demand is made by letter or other form of notice, the holders of indebtedness or other obligations may immediately commence an action against the relevant guarantor. There is no requirement under the deeds of guarantee to obtain a judgment, take other enforcement actions or wait any period of time prior to taking steps against the relevant guarantor. All actions or proceedings arising out of or in connection with the deeds of guarantee must be exclusively brought in courts in England.

Under the terms of the DLC transaction documents, Carnival Corporation and Carnival plc are permitted to transfer assets between the companies, make loans or investments in each other and otherwise enter into intercompany transactions. The companies have entered into some of these types of transactions and expect to enter into additional transactions in the future to take advantage of the flexibility provided by the DLC structure and to operate both companies as a single unified economic enterprise in the most effective manner. In addition, under the terms of the Equalization and Governance

Agreement and the deeds of guarantee, the cash flow and assets of one company are required to be used to pay the obligations of the other company, if necessary.

Given the DLC structure as described above, we believe that providing separate financial statements for each of Carnival Corporation and Carnival plc would not present a true and fair view of the economic realities of their operations. Accordingly, separate financial statements for both Carnival Corporation and Carnival plc have not been presented.

Simultaneously with the completion of the DLC transaction, a partial share offer ("PSO") for 20% of Carnival plc's shares was made and accepted, which enabled 20% of Carnival plc shares to be exchanged for 41.7 million Carnival Corporation shares. The 41.7 million shares of Carnival plc held by Carnival Corporation as a result of the PSO, which cost $1.05 billion, are being accounted for as treasury stock in the accompanying balance sheet. The holders of Carnival Corporation shares, including the new shareholders who exchanged their Carnival plc shares for Carnival Corporation shares under the PSO, now own an economic interest equal to approximately 79%, and holders of Carnival plc shares now own an economic interest equal to approximately 21%, of Carnival Corporation & plc.

The management of Carnival Corporation and Carnival plc ultimately agreed to enter into the DLC transaction because, among other things, the creation of Carnival Corporation & plc would result in a company with complementary well-known brands operating globally with enhanced growth opportunities, benefits of sharing best practices and generating cost savings, increased financial flexibility and access to capital markets and a DLC structure, which allows

for continued participation in an investment in the global cruise industry
by

Carnival plc's shareholders who wish to continue to hold shares in a UK-lis
ted
company.

Carnival plc was the third largest cruise company in the world and

operated many well-known global brands with leading positions in the U.S.,
UK,

Germany and Australia. The combination of Carnival Corporation with Carniv
al

plc under the DLC structure has been accounted for under U.S. generally

accepted accounting principles ("GAAP") as an acquisition of Carnival plc b
y

Carnival Corporation pursuant to SFAS No. 141. The purchase price of $25.3
1

per share was based upon the average of the quoted closing market price of

Carnival Corporation's shares beginning two days before and ending two days

after January 8, 2003, the date the Carnival plc board agreed to enter into

the DLC transaction. The number of additional shares effectively issued in

the combined entity for purchase accounting purposes was 209.6 million. In

addition, Carnival Corporation incurred approximately $60 million of direct

acquisition costs, which have been included in the purchase price. The
aggregate **purchase**
price of $5.36 billion, computed as described above, has
been allocated to the **assets**
and liabilities of Carnival plc as follows (in
millions):

Ships	$4,669
Ships under construction	233
Other tangible assets	868
Goodwill	2,248
Trademarks	1,291
Debt	(2,879)
Other liabilities	(1,072)
	$5,358

During the fourth quarter of fiscal 2003 an appraisal firm who we enga
ged

completed its valuation work in connection with establishing the estimated

fair values of Carnival plc's cruise ships and non-amortizable and amortizable intangible assets as of the April 17, 2003 acquisition date. Accordingly, we reduced the carrying values of 15 Carnival plc ships, including three ships which were under construction at the acquisition date, by $689 million. Trademarks are non-amortizable and represent the Princess, P&O Cruises, P&O Cruises Australia, AIDA, and A'ROSA trademarks' estimated fair values. There were no significant amortizable intangible assets identified in this appraisal firm's valuation study.

The information presented below gives pro forma effect to the DLC transaction between Carnival Corporation and Carnival plc. Management has prepared the pro forma information based upon the companies' reported financial information and, accordingly, the pro forma information should be read in conjunction with the companies' financial statements.

As noted above, the DLC transaction has been accounted for as an acquisition of Carnival plc by Carnival Corporation, using the purchase method of accounting. Carnival plc's accounting policies have been conformed to Carnival Corporation's policies. Carnival plc's reporting period has been changed to Carnival Corporation's reporting period and the information presented below covers the same periods of time for both companies.

This pro forma information has been prepared as if the DLC transaction had occurred on December 1, 2002 and 2001, respectively, rather than April 17, 2003, and has not been adjusted to reflect any net transaction benefits. In addition, this pro forma information does not purport to represent what the results of operations actually could have been if the DLC transaction had occurred on December 1, 2002 and 2001 or what those results will be for any future periods.

	Years ended November 30,	
	2003	2002
	(in millions, except earnings per share)	

Pro forma revenues	$7,596	$6,768
Pro forma net income (a)-(d)	$1,159	$1,271
Pro forma earnings per share		
Basic	$1.46	$1.60
Diluted	$1.45	$1.59
Pro forma weighted-average shares outstanding		
Basic	797	795
Diluted	805	800

(a) In accordance with SFAS No. 141, pro forma net income was reduced by $51 million in 2003 and $104 million in 2002 for Carnival plc's nonrecurring costs related to its terminated Royal Caribbean transaction and the completion of the DLC transaction with Carnival Corporation, which were expensed by Carnival plc prior to April 17, 2003.

(b) As a result of the reduction in depreciation expenses due to the revaluation of Carnival plc's ships carrying values, pro forma net income has been increased by $16 million in 2003 and $14 million in 2002.

(c) The 2002 pro forma net income included a $51 million nonrecurring income tax benefit related to an Italian incentive tax law, which allowed Costa to receive an income tax benefit for contractual expenditures during 2002 incurred on the construction of a new ship.

(d) The 2003 pro forma net income included a $13 million nonrecurring expense related to a DLC litigation matter and $19 million of income related to the receipt of nonrecurring net insurance proceeds.

NOTE 4 - Property and Equipment

Property and equipment consisted of the following (in millions):

	November 30,	
	2003	2002

Ships	$18,134	$10,666
Ships under construction	886	713
	-------	-------
	19,020	11,379
Land, buildings and improvements, and port facilities	504	315
Transportation equipment and other	549	409
	-------	-------
Total property and equipment	20,073	12,103
Less accumulated depreciation and amortization	(2,551)	(1,987)
	-------	-------
	$17,522	$10,116
	=======	=======

Capitalized interest, primarily on our ships under construction, amounted to $49 million, $39 million and $29 million in fiscal 2003, 2002 and 2001, respectively. Ships under construction include progress payments for the construction of the ship, as well as design and engineering fees, capitalized interest, construction oversight costs and various owner supplied items. At November 30, 2003, seven ships with an aggregate net book value of $1.94 billion were pledged as collateral pursuant to mortgages related to $1.04 billion of debt and a $469 million contingent obligation (see Notes 7 and 9). During fiscal 2003, $1.05 billion of ship collateral, which was pledged against $697 million of Carnival plc debt was released as collateral in exchange for revising the maturity dates of this debt and providing Carnival Corporation guarantees (see Note 7).

Maintenance and repair expenses and dry-dock amortization were $251 million, $175 million and $160 million in fiscal 2003, 2002 and 2001, respectively.

NOTE 5 - Impairment Charge

In fiscal 2002 we reduced the carrying value of one of our ships by recording an impairment charge of $20 million. In fiscal 2001, we recorded an impairment charge of $140 million, which consisted principally of a $71 million reduction in the carrying value of ships, a $36 million write-off of Seabourn goodwill, a $15 million write-down of a Holland America Line note receivable, and a $11 million loss on the sale of the Seabourn Goddess I and II. The impaired ships' and note receivable fair values were based on third party appraisals, negotiations with unrelated third parties or other available evidence, and the fair value of the impaired goodwill was based on our estimates of discounted future cash flows.

NOTE 6 - Investments In and Advances To Affiliates

On June 1, 2001, we sold our equity investment in Airtours plc, which resulted in a nonoperating net gain of $101 million and net cash proceeds of $492 million. Cumulative foreign currency translation losses of $59 million were reclassified from AOCI and included in determining the 2001 net gain.

NOTE 7 - Debt

Short-Term Borrowings

Short-term borrowings consisted of unsecured notes, bearing interest at libor plus 0.18% (1.3% weighted-average interest **rate** at November 30, 2003), repaid to a bank in December 2003.

Long-Term Debt

Long-term debt consisted of the following (in millions):

	November 30,	
(a)	2003(a)	2002
Secured		
Floating rate notes, collateralized by two ships,		

bearing interest at libor plus 1.25% and libor plus 1.29% (2.24% and 2.33% at November 30, 2003), due through 2015 (b)	$ 631	
Euro **floating rate note**, collateralized by one ship, bearing interest at euribor plus 0.5% (2.75% and 4.0 % at November 30, 2003 and 2002, respectively), due through 2008	115	$ 119
Euro fixed rate note, collateralized by one ship, bearing interest at 4.74%, due through 2012 (b)	182	
Capitalized lease obligations, collateralized by two ships, implicit interest at 3.66%, due through 2005	115	
Other	3	3
	-----	-----
	1,046	122
	-----	-----
Unsecured		
Fixed **rate notes**, bearing interest at 3.75% to 8.2%, due through 2028 (b)	2,123	857
Euro **floating rate notes**, bearing interest at euribor plus 0.35% to euribor plus 1.29% (2.4% to 3.9% and 3.8% to 4.0% at November 30, 2003 and 2002, respectively), due through 2008 (b)	1,129	570
Euro revolving credit facilities, bearing interest at euribor plus 0.50% and euro libor plus 0.98% (2.6% to 3.2% and 3.6% at November 30, 2003 and 2002, respectively), due through 2006 (b)	300	110
Sterling fixed **rate notes**, bearing interest at 6.4%, due in 2012 (b)	355	
Euro fixed **rate notes**, bearing interest at 5.57%, due in 2006	353	297
Floating rate note, bearing interest at libor plus 1.33% (2.45% at November 30, 2003), due through 2008 (b)	244	
Revolving credit facility, bearing interest at libor plus 0.17% (1.6% at November 30, 2002), due through 2006		50

Other	44	42
Convertible notes, bearing interest at 2%, due in 2021, with first put option in 2005(b)	600	600
Zero-coupon convertible notes, net of discount, with a face value of $1.05 billion, due in 2021, with first put option in 2006(b)	541	521
Convertible notes, bearing interest at 1.75%, net of discount, with a face value of $889 million, due in 2033, with first put option in 2008(b)	575	
	6,264	3,047
	7,310	3,169
Less portion due within one year	(392)	(155)
	$6,918	$3,014

(a) All borrowings are in U.S. dollars unless otherwise noted. Euro and sterling denominated notes have been translated to U.S. dollars at the period-end exchange rates. At November 30, 2003, 67%, 28% and 5% of our debt was U.S. dollar, euro and sterling denominated, respectively, and at November 30, 2002, 65% was U.S. dollar and 35% was euro denominated.

(b) At November 30, 2003, all of Carnival plc's $1.20 billion of debt was unconditionally guaranteed by P&O Princess Cruises International Limited ("POPCIL"), a 100% direct wholly-owned subsidiary of Carnival plc. On June 19, 2003, POPCIL, Carnival Corporation and Carnival plc executed a

deed of guarantee under which POPCIL agreed to guarantee all indebtedness and related obligations of both Carnival Corporation and Carnival plc incurred under agreements entered into after April 17, 2003, the date the DLC transaction was completed. Under this deed of guarantee, POPCIL also agreed to guarantee all other Carnival Corporation and Carnival plc indebtedness and related obligations that Carnival Corporation and Carnival plc agreed to guarantee under their deeds of guarantee. We anticipate that, in connection with corporate reorganization transactions that we expect to complete shortly, the POPCIL guarantee will terminate in accordance with its terms.

In addition, in exchange for certain amendments to Carnival plc's consolidated indebtedness, which was outstanding prior to April 17, 2003, Carnival Corporation has guaranteed substantially all of the Carnival plc consolidated pre-acquisition debt outstanding at November 30, 2003. Finally, Carnival plc has guaranteed all of the Carnival Corporation pre-acquisition debt outstanding at November 30, 2003.

Carnival Corporation's 2% convertible notes ("2% Notes"), its zero-coupon convertible notes ("Zero-Coupon Notes") and its 1.75% convertible notes ("1.75% Notes") are convertible into 15.3 million shares, 17.4 million shares and a maximum of 20.9 million shares, respectively, of Carnival Corporation common stock.

The 2% Notes are convertible at a conversion price of $39.14 per share, subject to adjustment, during any fiscal quarter for which the closing price of the Carnival Corporation common stock is greater than $43.05 per share for a defined duration of time in the preceding fiscal quarter. The conditions for conversion of the 2% Notes have not been met since their issuance in 20

01 through November 30, 2003.

The Zero-Coupon Notes have a 3.75% yield to maturity and are convertible during any fiscal quarter for which the closing price of the Carnival Corporation common stock is greater than a specified trigger price for a defined duration of time in the preceding fiscal quarter. The trigger price commenced at a low of $31.94 per share for the first quarter of fiscal 2002 and increases at an annual rate of 3.75% thereafter, until maturity. As of the end of the 2003 third and fourth quarters, the Zero-Coupon Notes became convertible into Carnival Corporation common stock for the 2003 fourth quarter and the 2004 first quarter as a result of Carnival Corporation's common stock achieving its target conversion trigger price per share of $33.77 and $34.09, respectively, for the requisite periods of time (see Note 15). No Zero-Coupon Notes were converted in fiscal 2003.

The 1.75% Notes, which were issued in April 2003, are convertible at a conversion price of $53.11 per share, subject to adjustment, during any fiscal quarter for which the closing price of the Carnival Corporation common stock is greater than a specified trigger price for a defined duration of time in the preceding fiscal quarter. During the fiscal quarters ending from August 31, 2003 through April 29, 2008, the trigger price will be $63.73 per share. Thereafter, this conversion trigger price increases each quarter based on an annual rate of 1.75%, until maturity. In addition, holders may also surrender the 1.75% Notes for conversion if they have been called for redemption or, for other specified occurrences, including the credit rating assigned to the 1.75%

Notes being Baa3 or lower by Moody's Investors Service and BBB- or lower by

Standard & Poor's Rating Services, as well as certain corporate transac
tions.

The conditions for conversion of the 1.75% Notes were not met during fiscal

2003. The 1.75% Notes interest is payable in cash semi-annually in arrears
,

commencing October 29, 2003 through April 29, 2008. Effective April 30, 20
08,

the 1.75% Notes no longer require a cash interest payment, but interest wil
l
accrete at a 1.75% yield to maturity.

Subsequent to April 29, 2008 and October 23, 2008, we may redeem all o
r a

portion of the 1.75% Notes and Zero-Coupon Notes, respectively, at their

accreted values and subsequent to April 14, 2008, we may redeem all or a

portion of our 2% Notes at their face value plus any unpaid accrued interes
t.

In addition, on April 29, 2008, 2013, 2018, 2023 and 2028 the 1.75%

Noteholders, on April 15 of 2005, 2008 and 2011 the 2% Noteholders and on

October 24 of 2006, 2008, 2011 and 2016 the Zero-Coupon Noteholders may

require us to repurchase all or a portion of the outstanding 1.75% Notes an
d

Zero-Coupon Notes at their accreted values and the 2% Notes at their face
value plus any unpaid accrued interest.

Upon conversion, redemption or repurchase of the 1.75% Notes, the 2%

Notes and the Zero-Coupon Notes we may choose to deliver Carnival Corporati
on

common stock, cash or a combination of cash and common stock with a total

value equal to the value of the consideration otherwise deliverable. If the

1.75% Notes, 2% Notes and Zero-Coupon Notes were to be put back to us, we

would expect to settle them for cash and, accordingly, they are not include
d

in our diluted earnings per share common stock calculations, unless they

become convertible and are dilutive to our earnings per share computation.

However, no assurance can be given that we will have sufficient liquidity t
o

make such cash payments. See Note 15.

Costa has a 257.5 million euro ($303 million U.S. dollars at the November 30, 2003 exchange rate) unsecured euro revolving credit facility, which expires in May 2006, of which $219 million was available at November 30, 2003. In addition, POPCIL has $710 million of unsecured revolving multi-currency credit facilities, which expire in September 2005, of which $494 million was available at November 30, 2003.

Carnival Corporation's $1.4 billion unsecured multi-currency revolving credit facility matures in June 2006. This facility currently bears interest at libor/eurolibor plus 20 basis points ("BPS"), which interest rate spread over the base rate will vary based on changes to Carnival Corporation's senior unsecured debt ratings, and provides for an undrawn facility fee of ten BPS. Carnival Corporation's commercial paper program is supported by this revolving credit facility and, accordingly, any amounts outstanding under its commercial paper program, none at November 30, 2003 and 2002, reduce the aggregate amount available under this facility. At November 30, 2003, the entire facility was available.

This $1.4 billion facility and other of our loan and derivative agreements contain covenants that require us, among other things, to maintain a minimum debt service coverage and limits our debt to capital ratios and debt to equity ratio, and the amounts of our secured assets and secured indebtedness, and shareholders' equity. In addition, if our business suffers a material adverse change or if other events of default under our loan agreements are triggered, then pursuant to cross default acceleration clauses, substantially all of our outstanding debt and derivative contract payables

could become due and the underlying facilities could be terminated. At November 30, 2003, we were in compliance with all of our debt covenants.

In November 2003, we issued $550 million of unsecured 3.75% Notes due in November 2007, the proceeds of which we used to repay some of the amounts outstanding under the POPCIL $710 million credit facilities and for working capital purposes.

At November 30, 2003, the scheduled annual maturities of our long-term debt was as follows (in millions):

Fiscal	
2004	$ 392
2005	1,263(a)
2006	1,587(a)
2007	999
2008	1,492(a)
Thereafter	1,577
	$7,310

(a) Includes $600 million of Carnival Corporation's 2% Notes in 2005, $541 million of its Zero-Coupon Notes in 2006, and $575 million of its 1.75% Notes in 2008, based in each case on the date of the noteholders' first put option.

Debt issuance costs are generally amortized to interest expense using the straight-line method, which approximates the effective interest method, over the term of the notes or the noteholders first put option date, whichever is earlier. In addition, all loan issue discounts are amortized to interest expense using the effective interest rate method over the term of the notes.

NOTE 8 - Commitments

Ship Commitments

A description of our ships under contract for construction at November 30, 2003 was as follows (in millions, except passenger capacity):

Brand and Ship	Expected Service Date(a)	Shipyard	Passenger Capacity	Estimated Total Cost(b)
Princess				
Diamond Princess	3/04	Mitsubishi	2,674	$ 475
Caribbean Princess	4/04	Fincantieri(c)	3,114	500
Sapphire Princess	6/04	Mitsubishi	2,674	475
Newbuild	6/06	Fincantieri	3,114	500
Total Princess			11,576	1,950
CCL				
Carnival Miracle	2/04	Masa-Yards (c)(d)	2,124	375
Carnival Valor	12/04	Fincantieri(c)	2,974	510
Carnival Liberty	8/05	Fincantieri	2,974	460
Total CCL			8,072	1,345
Holland America Line				
Westerdam	4/04	Fincantieri(c)	1,848	410
Noordam	2/06	Fincantieri(c)	1,848	410
Total Holland America Line			3,696	820
Cunard				
Queen Mary 2	1/04	Chantiers de L'Atlantique(c)(d)	2,620	800
Queen Victoria	4/05	Fincantieri (c)	1,968	410

Total Cunard			4,588	1,210
			------	------
Costa				
Costa Magica	11/04	Fincantieri(e)	2,702	545
			------	------
Total			30,634	$5,870
			======	======

(a) The expected service date is the month in which the ship is currently expected to begin its first revenue generating cruise.

(b) Estimated total cost of the completed ship includes the contract price with the shipyard, design and engineering fees, capitalized interest, construction oversight costs and various owner supplied items.

(c) These construction contracts are denominated in euros and have been fixed into U.S. dollars through the utilization of forward foreign currency contracts.

(d) The Carnival Miracle and the Queen Mary 2 were delivered in February 2004 and December 2003, respectively.

(e) This construction contract is denominated in euros, which is Costa's functional currency and, therefore, we have not entered into a forward foreign currency contract to hedge this commitment. The estimated total cost has been translated into U.S. dollars using the November 30, 2003 exchange rate.

In addition to these ship construction contracts, in January 2004, Costa entered into a letter of intent for a 3,004-passenger ship with Fincantieri for a Summer 2006 delivery date at an estimated total cost of 450 million euros.

In connection with our cruise ships under contract for construction, we have paid $876 million through November 30, 2003 and anticipate paying the remaining estimated total costs as follows: $2.98 billion in 2004, $1.24 billion in 2005 and $775 million in 2006.

Operating Leases

Rent expense under our operating leases, primarily for office and warehouse space, was $48 million, $15 million and $13 million in fiscal 2003, 2002 and 2001, respectively. At November 30, 2003, minimum annual rentals for our operating leases, with initial or remaining terms in excess of one year, were as follows (in millions): $57, $49, $36, $26, $23 and $85 in fiscal 2004 through 2008 and thereafter, respectively.

Port Facilities and Other

At November 30, 2003, we had commitments through 2052, with initial or remaining terms in excess of one year, to pay minimum amounts for our annual usage of port facilities and other contractual commitments as follows (in millions): $57, $32, $33, $35, $35 and $200 in fiscal 2004 through 2008 and thereafter, respectively.

NOTE 9 - Contingencies

Litigation

In 2002, two actions (collectively, the "Facsimile Complaints") were filed against Carnival Corporation on behalf of purported classes of persons who received unsolicited advertisements via facsimile, alleging that Carnival Corporation and other defendants distributed unsolicited advertisements via facsimile in contravention of the U.S. Telephone Consumer Protection Act. The plaintiffs seek to enjoin the sending of unsolicited facsimile advertisements and statutory damages. The advertisements referred to in the Facsimile Complaints were not sent by Carnival Corporation, but rather were distributed by a professional faxing company at the behest of travel agencies that referenced a CCL product. We do not advertise directly to the traveling public through the use of facsimile transmission. The ultimate outcomes of the Facsimile Complaints cannot be determined at this time. We believe that

we have meritorious defenses to these claims and, accordingly, we intend to vigorously defend against these actions.

In February 2001, Holland America Line-USA, Inc. ("HAL-USA"), a wholly-owned subsidiary, received a grand jury subpoena requesting that it produce documents and records relating to the air emissions from Holland America Line ships in Alaska. HAL-USA responded to the subpoena. The ultimate outcome of this matter cannot be determined at this time.

On August 17, 2002, an incident occurred in Juneau, Alaska onboard Holland America Line's Ryndam involving a wastewater discharge from the ship. As a result of this incident, various Ryndam ship officers and crew have received grand jury subpoenas from the Office of the U.S. Attorney in Anchorage, Alaska requesting that they appear before a grand jury. One subpoena also requested the production of Holland America Line documents, which Holland America Line has produced. Holland America Line is also complying with a subpoena for additional documents. If the investigation results in charges being filed, a judgment could include, among other forms of relief, fines and debarment from federal contracting, which would prohibit operations in Glacier Bay National Park and Preserve during the period of debarment. The State of Alaska is separately investigating this incident. The ultimate outcomes of these matters cannot be determined at this time. However, if Holland America Line were to lose its Glacier Bay permits we would not expect the impact on our financial statements to be material to us since we believe there are additional attractive alternative destinations in Alaska that can be substituted for Glacier Bay.

Costa has instituted arbitration proceedings in Italy to confirm the validity of its decision not to deliver its ship, the Costa Classica, to the shipyard of Cammell Laird Holdings PLC ("Cammell Laird") under a 79 million

euro denominated contract for the conversion and lengthening of the ship. Costa has also given notice of termination of the contract. It is now expected that the arbitration tribunal's decision will be made in late-2004 at the earliest. In the event that an award is given in favor of Cammell Laird, the amount of damages, which Costa would have to pay, if any, is not currently determinable. The ultimate outcome of this matter cannot be determined at this time.

On April 23, 2003, Festival Crociere S.p.A. commenced an action against the European Commission (the "Commission") in the Court of First Instance of the European Communities in Luxembourg seeking to annul the Commission's antitrust approval of the DLC transaction (the "Festival Action"). We have been granted leave to intervene in the Festival Action and intend to contest such action vigorously. A successful third party challenge of an unconditional Commission clearance decision would be unprecedented, and based on a review of the law and the factual circumstances of the DLC transaction, as well as the Commission's approval decision in relation to the DLC transaction, we believe that the Festival Action will not have a material adverse effect on the companies or the DLC transaction. However, the ultimate outcome of this matter cannot be determined at this time.

In the normal course of our business, various other claims and lawsuits have been filed or are pending against us. Most of these claims and lawsuits are covered by insurance and, accordingly, the maximum amount of our liability is typically limited to our self-insurance retention levels. However, the ultimate outcome of these claims and lawsuits which are not covered by insurance cannot be determined at this time.

Contingent Obligations

At November 30, 2003, we had contingent obligations totaling $1.08

billion to participants in lease out and lease back type transactions for three of our ships. At the inception of the leases, the entire amount of the contingent obligations was paid by us to major financial institutions to enable them to directly pay these obligations. Accordingly, these obligations were considered extinguished, and neither funds nor the contingent obligations have been included on our balance sheets. We would only be required to make any payments under these contingent obligations in the remote event of nonperformance by these financial institutions, all of which have long-term credit ratings of AAA or AA. In addition, we obtained a direct guarantee from another AAA rated financial institution for $298 million of the above noted contingent obligations, thereby further reducing the already remote exposure to this portion of the contingent obligations. If the major financial institutions' credit ratings fall below AA-, we would be required to move a majority of the funds from these financial institutions to other highly-rated financial institutions. If Carnival Corporation's credit rating falls below BBB, we would be required to provide a standby letter of credit for $90 million, or alternatively provide mortgages in the aggregate amount of $90 million on two of Carnival Corporation's ships.

In the unlikely event that we were to terminate the three lease agreements early or default on our obligations, we would, as of November 30, 2003 have to pay a total of $168 million in stipulated damages. As of November 30, 2003, $177 million of standby letters of credit have been issued by a major financial institution in order to provide further security for the payment of these contingent stipulated damages. In the event we were to default under our $1.4 billion revolving credit facility, we would be required to post cash collateral to support the stipulated damages standby letters of

credit. Between 2017 and 2022, we have the right to exercise options that would terminate these transactions at no cost to us. As a result of these three transactions, we have $40 million and $43 million of deferred income recorded on our balance sheets as of November 30, 2003 and 2002, respectively, which is being amortized to nonoperating income through 2022.

Other Contingent Obligations

Some of the debt agreements that we enter into include indemnification provisions that obligate us to make payments to the counterparty if certain events occur. These contingencies generally relate to changes in taxes, changes in laws that increase lender capital costs and other similar costs. The indemnification clauses are often standard contractual terms and were entered into in the normal course of business. There are no stated or notional amounts included in the indemnification clauses and we are not able to estimate the maximum potential amount of future payments, if any, under these indemnification clauses. We have not been required to make any payments under such indemnification clauses in the past and, under current circumstances, we do not believe a request for indemnification is probable.

NOTE 10 - Income and Other Taxes

We believe that substantially all of our income, with the exception of our U.S. source income from the transportation, hotel and tour businesses of Holland America Tours and Princess Tours and the items listed in the regulations under Section 883 that the Internal Revenue Service does not consider to be incidental to ship operations discussed in the following paragraph, is exempt from U.S. federal income taxes. If we were found not to qualify for exemption pursuant to applicable income tax treaties or under the Internal Revenue Code or if the income tax treaties or Internal Revenue Code were to be changed in a manner adverse to us, a portion of our income would become subject to taxation by the U.S. at higher than normal corporate tax rates.

On August 26, 2003, final regulations under Section 883 of the Internal Revenue Code were published in the Federal Register. Section 883 is the primary provision upon which we rely to exempt certain of our international ship operation earnings from U.S. income taxes. The final regulations list elements of income that are not considered to be incidental to ship operations and, to the extent earned within the U.S., are subject to U.S. income tax. Among the items identified in the final regulations are income from the sale of air and other transportation, shore excursions and pre-and post cruise land packages. These rules will first be effective for us in fiscal 2004.

AIDA, A'ROSA, Ocean Village, P&O Cruises, P&O Cruises Australia and Swan Hellenic are all strategically and commercially managed in the UK and have elected to enter the UK tonnage tax regime. Accordingly, these operations pay UK corporation tax on shipping profits calculated by reference to the net tonnage of qualifying vessels. Income not considered to be shipping profits is taxable under the normal UK tax rules. We believe that substantially all of the income attributable to these brands constitutes shipping profits and, accordingly, income tax expense from these operations has been and is expected to be minimal.

Some of our subsidiaries, including Costa, Holland America Tours, Princess Tours and other of our non-shipping activities, are subject to foreign and/or U.S. federal and state income taxes. In fiscal 2003, we recognized a net $29 million income tax expense, primarily related to these operations. In 2002, we recognized a net $57 million income tax benefit primarily due to an Italian investment incentive law, which allowed Costa to receive a $51 million income tax benefit based on contractual expenditures during 2002 on the construction of a new ship. At November 30, 2003, Costa had a remaining net deferred tax asset of approximately $61 million relating primarily to the tax benefit of the net operating loss carryforwards arising

from this incentive law, which expire in 2007. In fiscal 2001, we recognized a $9 million income tax benefit from Costa primarily due to changes in Italian tax law.

We do not expect to incur income taxes on future distributions of undistributed earnings of foreign subsidiaries and, accordingly, no deferred income taxes have been provided for the distribution of these earnings.

In addition to or in place of income taxes, virtually all jurisdictions where our ships call, impose taxes based on passenger counts, ship tonnage or some other measure. These taxes, other than those directly charged to and/or collected from passengers by us, are recorded as operating expenses in the accompanying statements of operations.

NOTE 11 - Shareholders' Equity

Carnival Corporation's articles of incorporation authorize its Board of Directors, at its discretion, to issue up to 40 million shares of its preferred stock and Carnival plc has 100,000 authorized preference shares. At November 30, 2003 and 2002, no Carnival Corporation preferred stock had been issued and only a nominal amount of Carnival plc preferred shares had been issued.

At November 30, 2003, there were 91.7 million shares of Carnival Corporation common stock reserved for issuance pursuant to its convertible notes and its employee benefit and dividend reinvestment plans. In addition, Carnival plc shareholders have authorized 4.8 million ordinary shares for future issuance under its employee benefit plans.

At November 30, 2003 and 2002, AOCI included cumulative foreign currency translation adjustments which increased shareholders' equity by $191 million and $29 million, respectively.

NOTE 12 - Financial Instruments

We estimated the fair value of our financial instruments through the use of public market prices, quotes from financial institutions and other available information. Considerable judgment is required in interpreting data to develop estimates of fair value and, accordingly, amounts are not necessarily indicative of the amounts that we could realize in a current market exchange. Our financial instruments are not held for trading or other speculative purposes.

Cash and Cash Equivalents

The carrying amounts of our cash and cash equivalents approximate their fair values due to their short maturities.

Other Assets

At November 30, 2003 and 2002, long-term other assets included marketable securities held in rabbi trusts for certain of our nonqualified benefit plans and notes and other receivables. These assets had carrying and fair values of $225 million at November 30, 2003 and $173 million at November 30, 2002. Fair values were based on public market prices, estimated discounted future cash flows or estimated fair value of collateral.

Debt

The fair values of our non-convertible debt and convertible notes were $5.83 billion and $1.92 billion, respectively, at November 30, 2003 and $2.04 billion and $1.28 billion at November 30, 2002. These fair values were greater than the related carrying values by $140 million and $205 million, respectively, at November 30, 2003 and $4 million and $162 million at November 30, 2002. The net difference between the fair value of our debt and its carrying value was due primarily to our issuance of **debt obligations** at fixed interest rates that are above market interest rates in existence at the measurement dates, as well as the impact of changes in the Carnival Corporation

common stock value on our convertible notes on those dates. The fair values of our unsecured fixed rate public notes, convertible notes, sterling bonds and unsecured 5.57% euro notes were based on their public market prices. The fair values of our other debt were estimated based on appropriate market interest rates being applied to this debt.

Foreign Currency Contracts

We have forward foreign currency contracts, designated as foreign currency fair value hedges, for seven of our euro denominated shipbuilding contracts (see Note 8). At November 30, 2003 and 2002, the fair value of these forward contracts was an unrealized gain of $363 million and an unrealized loss of $178 million, respectively. These forward contracts mature through 2006. The fair values of our forward contracts were estimated based on prices quoted by financial institutions for these instruments.

We have cross currency swaps totaling $644 million that are designated as hedges of our net investments in foreign subsidiaries, which have euro and sterling denominated functional currencies. These cross currency swaps were entered into to effectively convert U.S. dollar denominated debt into euro or sterling debt, which acts as a hedge of our net investments in cruise lines whose functional currencies are the euro and sterling. At November 30, 2003, the fair value of these cross currency swaps was an unrealized loss of $49 million, of which $39 million is included in the cumulative translation adjustment component of AOCI. These currency swaps mature through 2007. We also have $171 million of cross currency swaps, which effectively converts euro denominated debt into sterling debt, which is the functional currency of our subsidiary which was the borrower. At November 30, 2003, the fair value of these cross euro/sterling currency swaps was a loss of $21 million. These

currency swaps mature through 2012. The fair value of our cross currency swaps were estimated based on prices quoted by financial institutions for these instruments. Finally, we have designated $355 million of outstanding sterling debt, which is a nonderivative and matures in 2012, as a hedge of our net investments in foreign operations and, accordingly, have included $24 million of foreign currency transaction losses in the cumulative translation adjustment component of AOCI at November 30, 2003.

Interest Rate Swaps

We have interest rate swap agreements designated as fair value hedges whereby we receive fixed interest rate payments in exchange for making variable interest rate payments. At November 30, 2003 and 2002, these interest rate swap agreements effectively changed $1.19 billion and $225 million of fixed rate debt to Libor-based floating rate debt.

In addition, we also have interest rate swap agreements designated as cash flow hedges whereby we receive variable interest rate payments in exchange for making fixed interest rate payments. At November 30, 2003 and 2002, these interest rate swap agreements effectively changed $760 million and $468 million, respectively, of euribor floating rate debt to fixed rate debt.

These interest rate swap agreements mature through 2012. At November 30, 2003 and 2002, the fair value of our interest rate swaps was a loss of $6 million and $0.1 million, respectively. The fair values of our interest rate swap agreements were estimated based on prices quoted by financial institutions for these instruments.

NOTE 13 - Segment Information

Our cruise segment included thirteen cruise brands since April 17, 2003, and six Carnival Corporation cruise brands from December 1, 2001 to April 16, 2003, which have been aggregated as a single reportable segment based on the similarity of their economic and other characteristics.

Our other segment represents the transportation, hotel and tour

operations of Holland America Tours and Princess Tours and the business to business travel agency operations of P&O Travel Ltd., the latter two since completion of the DLC transaction on April 17, 2003. The significant accounting policies of our segments are the same as those described in Note 2 -"Summary of Significant Accounting Policies." Information for our cruise and other segments as of and for the year ended November 30, was as follows (in millions):

	Revenues (a)	Operating expenses (b)	Selling and adminis-trative	Depreciation and amortization	Operating income (loss)	Capital expend-itures	Total assets
2003							
Cruise	$6,459	$3,624	$896	$568	$1,371	$2,454	$24,090
Other (c)	345	280	36	17	12	62	401
Intersegment elimination	(86)	(86)					
	$6,718	$3,818	$932	$585	$1,383	$2,516	$24,491
2002							
Cruise(d)	$4,244	$2,222	$577	$371	$1,055(c)	$1,949	$12,120
Other (c)	176	145	32	11	(13)	37	215
Intersegment elimination	(37)	(37)					
	$4,383	$2,330	$609	$382	$1,042	$1,986	$12,335
2001							
Cruise(d)	$4,371	$2,347	$584	$361	$ 946(e)	$ 802	$11,375
Other (c)	229	186	35	11	(10)(e)	25	189
Affiliated operations(f)					(44)		

Intersegment elimination		(51)	(51)				
	$4,549	$2,482	$619	$372	$ 892	$ 827	$11,564

(a) Other revenues included revenues for the cruise portion of a tour, when a cruise is sold along with a land tour package by Holland America Tours and Princess Tours, and shore excursion and port hospitality services provided to cruise passengers by these tour companies. These intersegment revenues are eliminated from other revenues in the line "Intersegment elimination."

(b) Revenue amounts in 2002 and 2001 have been reclassified to conform to the 2003 presentation.

(c) Other assets primarily included hotels and lodges in Alaska and the Canadian Yukon, luxury dayboats offering tours to the glaciers of Alaska and the Yukon River, motor coaches used for sightseeing and charters in the States of Washington and Alaska, British Columbia, Canada and the Canadian Yukon and private, domed rail cars, which run on the Alaska Railroad between Anchorage and Fairbanks.

(d) In 2003, we commenced allocating all corporate expenses to our cruise segment. Accordingly, the 2002 and 2001 presentations have been restated to allocate the previously unallocated 2002 and 2001 corporate expenses and assets to our cruise segment.

(e) Cruise operating income included impairment charges of $20 million in 2002 and $134 million in 2001 and other operating loss included an impairment charge of $6 million in 2001.

(f) On June 1, 2001, we sold our investment in Airtours. Accordingly, we did not record any equity in the earnings or losses of Airtours after May 31,

2001.

Foreign revenues for our cruise brands represent sales generated from outside the U.S. primarily by foreign tour operators and foreign travel agencies. Substantially all of these foreign revenues are from the UK, Italy, Germany, Canada, France, Australia, Spain, Switzerland and Brazil.

Substantially all of our long-lived assets are located outside of the U.S. and consist principally of our goodwill, trademarks, ships and ships under construction.

Revenue information by geographic area for fiscal 2003, 2002 and 2001 was as follows (in millions):

	2003	2002	2001
U.S.	$4,513	$3,304	$3,500
Foreign	2,205	1,079	1,049
	$6,718	$4,383	$4,549

NOTE 14 - Benefit Plans

Stock Option Plans

We have stock option plans primarily for supervisory and management level employees and members of our Board of Directors. The Carnival Corporation and Carnival plc plans are administered by a committee of three of our directors (the "Committee") which determines who is eligible to participate, the number of shares for which options are to be granted and the amounts that may be exercised within a specified term. The Carnival Corporation and Carnival plc option exercise price is generally set by the Committee at 100% of the fair market value of the common stock/ordinary shares on the date the option is granted. Substantially all Carnival Corporation options granted during fiscal 2003, 2002 and 2001 and Carnival plc options granted in 2003 were granted at

an exercise price per share equal to the fair market value of the Carnival Corporation common stock and Carnival plc ordinary shares, respectively, on the date of grant. Carnival Corporation employee options generally vest evenly over five years and have a ten year term. Carnival plc employee options generally vest at the end of three years and have a ten year term. Carnival Corporation director options granted subsequent to fiscal 2000 vest evenly over five years and have a ten year term. At November 30, 2003, Carnival Corporation had 34.9 million shares and Carnival plc had 4.8 million shares, which were available for future grants under the option plans.

A combined summary of the activity and status of the Carnival Corporation and Carnival plc stock option plans was as follows:

	Weighted Average Exercise Price Per Share			Number of Options Years Ended November 30,		
	2003	2002	2001	2003	2002	2001
Outstanding options-beginning of year	$29.26	$28.95	$26.80	11,828,958	12,774,293	8,840,793
Carnival plc outstanding options at April 17, 2003(a)	$19.64			5,523,013		
Options granted	$30.88	$26.54	$26.44	5,464,109	33,000	6,580,250
Options exercised(b)	$17.35	$14.35	$11.70	(2,919,554)	(404,615)	(2,218,075)
Options canceled	$28.64	$32.80	$35.15	(598,547)	(573,720)	(428,675)
Outstanding options-end of year (e)	$28.79	$29.26	$28.95	19,297,979(c)	11,828,958	12,774,

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Options exercisable-end of year	$27.68	$28.71	$25.96	7,848,335(d)	4,775,894	2,972,498

(a) All Carnival plc unvested options outstanding on the date the DLC transaction was completed vested fully on such date, except for 1.3 million options, which were granted on April 15, 2003.

(b) Included 1.8 million Carnival plc options in 2003, of which 1.0 million had a sterling denominated exercise price.

(c) Included 3.6 million of Carnival plc options at a weighted average exercise price of $20.89 per share, based on the November 30, 2003 U.S. dollar to sterling exchange rate.

(d) Included 2.2 million of Carnival plc options at a weighted average exercise price of $18.06 per share.

(e) On December 1, 2003, as a result of the Princess cruise operations being transferred to the Carnival Corporation side of the DLC structure, options to purchase 567,000 shares of Carnival plc vested immediately, and the termination date of 1.5 million Carnival plc exercisable options were shortened to the earlier of 12 months after the December 1, 2003 reorganization date or 42 months after the date of grant. All such changes have been made pursuant to the original terms of the Carnival plc plan.

Combined information with respect to outstanding and exercisable Carnival Corporation and Carnival plc stock options at November 30, 2003 was as follows:

	Options Outstanding		Options Exercisable
	Weighted Average	Weighted Average	Weighted Average

Exercise Price Range	Shares	Remaining Life (Years)	Exercise Price	Shares	Exercise Price
$ 1.94-$ 2.25	30,980	(a)	$ 2.07	30,980	$ 2.07
$10.59-$15.00	735,102	5.4	$13.54	735,102	$13.54
$16.28-$22.57	4,477,849	7.1	$20.71	2,617,539	$19.70
$23.04-$27.88	5,714,089	8.4	$26.44	1,319,694	$25.00
$28.21-$34.91	5,518,009	8.4	$32.12	1,172,570	$30.27
$36.72-$41.34	102,000	4.8	$38.09	97,600	$38.06
$43.56-$48.56	2,719,950	5.7	$44.36	1,874,850	$44.50
Total	19,297,979	7.6	$28.79	7,848,335	$27.68

(a) These stock options do not have an expiration date.

Carnival Corporation Restricted Stock

Carnival Corporation has issued restricted stock to a few officers. These shares have the same rights as Carnival Corporation common stock, except for transfer restrictions and forfeiture provisions. During fiscal 2003, 2002 and 2001, 455,000 shares, 150,000 shares and 150,000 shares, respectively, of Carnival Corporation common stock were issued, which were valued at $14 million, $4 million and $5 million, respectively. Unearned stock compensation was recorded within shareholders' equity at the date of award based on the

quoted market price of the Carnival Corporation common stock on the date of grant and is amortized to expense using the straight-line method from the grant date through the earlier of the vesting date or the officers estimated retirement date. These shares either have three or five-year cliff vesting or vest evenly over five years after the grant date. As of November 30, 2003 and 2002 there were 1,055,000 shares and 750,000 shares, respectively, issued under the plan which remained to be vested.

Defined Benefit Pension Plans

We have several defined benefit pension plans, which cover some of our shipboard and shoreside employees. The U.S. and UK shoreside employee plans are closed to new membership. The plans are funded, at a minimum, in accordance with U.S. or UK regulatory requirements, with the remaining plans being primarily unfunded. In determining our plans' benefit obligations at November 30, 2003, we used assumed weighted-average discount rates of 6.0% and 5.3% for our U.S. and foreign plans, respectively. The net liabilities related to the obligations under these single employer defined benefit pension plans are not material.

A minimum pension liability adjustment is required when the actuarial present value of accumulated benefits exceeds plan assets and accrued pension liabilities. At November 30, 2003 and 2002, our single employer plans had aggregated additional minimum pension liability adjustments, less allowable intangible assets, of $14 million and $15 million, respectively, which are included in AOCI.

In addition, P&O Cruises participated in a Merchant Navy Ratings Pension Fund ("MNRPF"), which is a defined benefit multiemployer pension plan. This plan has a significant funding deficit and has been closed to further benefit

accrual since prior to the completion of the DLC transaction. P&O Cruises, along with other unrelated employers, are making payments into this plan under a non-binding Memorandum of Understanding to reduce the deficit. Accordingly, at November 30, 2003, we had recorded a long-term pension liability of $19 million, which represented our estimate of the present value of the entire liability due by us under this plan.

P&O Cruises, Princess and Cunard Line Limited also participate in an industry-wide British merchant navy officers pension fund ("MNOPF"), which also is a defined benefit multiemployer pension plan that is available to certain of their shipboard British officers. The MNOPF is divided into two sections, the "New Section" and the "Old Section", each of which covers a different group of participants, with the Old Section closed to further benefit accrual and the New Section only closed to new membership. Holland America Line also participates in a Dutch shipboard officers defined benefit multiemployer pension plan. Our multiemployer yearly pension fund plan expenses are based on the amount of contributions we are required to make annually into the plans.

Total expense for all of our defined benefit pension plans, including our multiemployer plans, was $17 million, $11 million and $8 million in fiscal 2003, 2002 and 2001, respectively.

As of March 31, 2003, the date of the most recent formal actuarial valuation prepared by the MNOPF's actuary, the New Section of the MNOPF was estimated to have a fund deficit of approximately 200 million sterling, or $340 million, assuming a 7.7% discount rate. At November 30, 2003, our external actuary informally updated the March 31, 2003 valuation and estimated that the New Section deficit was approximately 640 million sterling, or $1.1 billion, assuming a 5.3% discount rate. The 5.3% is the assumed discount r

ate

we have used for determining our other foreign pension plans obligations.

Based solely upon our share of current contributions to the MNOPF, our shar
e of these deficit amounts would be between $27 million and $85 million, depending on whether the deficit was $340 million or $1.1 billion, respectively. However, the extent of our portion of any liability with respect to the fund's deficit is uncertain, and is the subject of ongoing litigation, the outcome of which cannot be determined at this time. In addition, the amount of the fund deficit is subject to estimates and assumptions, which could cause the deficit amount to vary considerably.

A substantial portion of any MNOPF fund deficit liability which we may have relates to P&O Cruises and Princess liabilities which existed prio
r to the DLC transaction. However, since the MNOPF is a multiemployer plan and it is not probable that we will withdraw from the plan nor is our share of the liability certain, we are required to record our MNOPF plan expenses, including any contributions to fund the deficit, as they are contributed, instead of as a Carnival plc acquisition liability that existed at the DLC transaction date. It is currently expected that deficit funding contributions, if any, will be required to be paid over at least ten years.

Defined Contribution Plans

We have several defined contribution plans available to substantially all employees. We contribute to these plans based on employee contributions, salary levels and length of service. Total expense relating to these plans was $12 million, $8 million and $8 million in fiscal 2003, 2002 and 2001, respectively.

NOTE 15 - Earnings Per Share

Our basic and diluted earnings per share were computed as follows (in millions, except per share data):

	Years Ended November 30,		
	2003	2002	200

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Net income	$1,194	$1,016	$926
Interest on dilutive convertible notes	5		
Net income for diluted earnings per share	$1,199	$1,016	$926
Weighted-average common and ordinary shares outstanding	718	587	585
Dilutive effect of convertible notes	4		
Dilutive effect of stock plans	2	1	2
Diluted weighted-average shares outstanding	724	588	587
Basic earnings per share	$1.66	$1.73	$1.58
Diluted earnings per share	$1.66	$1.73	$1.58

The weighted-average shares outstanding for the year ended November 30, 2003 includes the pro rata Carnival plc shares since April 17, 2003.

If Carnival Corporation's common stock price reaches specified trigger prices for a defined duration of time within a completed quarter, then, under the terms of various classes of Carnival Corporation's convertible debt

securities (each having its own trigger prices), such classes of debt securities will become convertible for the next succeeding quarter, and the shares of Carnival Corporation common stock into which those debt securities become convertible will be considered outstanding for the most recently completed quarter's diluted earnings per share computation, if dilutive.

Carnival Corporation's Zero-Coupon Notes' contingent conversion trigger price was reached in the second half of fiscal 2003. Accordingly, the diluted earnings per share computation included an adjustment to increase net income for the imputed interest expense recorded on these Zero-Coupon Notes and the diluted weighted-average shares outstanding for fiscal 2003 included the weighted-average of the 17.4 million shares that could be converted at the noteholders' options. The conversion of these notes was only dilutive in the 2003 third quarter.

Our diluted earnings per share computation for fiscal 2003 did not include a maximum of 36.2 million (32.7 million in 2002 and 2001) shares of Carnival Corporation common stock issuable upon conversion of its convertible debt, as this common stock was not issuable under the contingent conversion provisions of these debt instruments (see Note 7).

Options to purchase 8.4 million, 6.0 million and 5.4 million shares for fiscal 2003, 2002 and 2001, respectively, were excluded from our diluted earnings per share computation since the effect of including them was anti-dilutive.

NOTE 16 - Supplemental Cash Flow Information

	Years Ended November 30,		
	2003	2002	2001

	(in millions)		
Cash paid for			
Interest, net of amount capitalized	$156	$110	$109
Income taxes, net	$ 21		$ 4
Other noncash investing and financing activities			
Common stock received as payment of stock option exercise price			$ 23
Notes received upon the sale of the Nieuw Amsterdam		$60	

NOTE 17 - Recent Accounting Pronouncement

In January 2003, as amended, the Financial Accounting Standards Board ("FASB") issued Financial Accounting Standards Board Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities." FIN No. 46 requires consolidation of variable interest entities ("VIE's") by the "primary beneficiary", as defined, if certain criteria are met. FIN No. 46 is effective immediately for VIE's created or acquired after January 31, 2003. For pre-existing VIE's, disclosure requirements are effective immediately and consolidation provisions are effective for our 2004 second quarter. In accordance with FIN No. 46, we have determined that we are carrying a loan, initially made in April 2001, to a ship repair facility that is a VIE. Although we use this facility for some of our ship repair work, we are not a "primary beneficiary" and, accordingly, this entity will not be consolidated in our financial statements. At November 30, 2003, our loan to this VIE, which is also our maximum exposure to loss, was $41 million.

Report of Independent Certified Public Accountants

To the Boards of Directors and Shareholders of
Carnival Corporation and Carnival plc

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, cash flows and shareholders' equity present fairly, in all material respects, the financial position of Carnival Corporation & plc (comprising Carnival Corporation and Carnival plc and their respective subsidiaries) at November 30, 2003 and 2002, and the results of

their operations and their cash flows for each of the three years in the period ended November 30, 2003 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note 2 to the financial statements, the Company adopted SFAS No.142 "Goodwill and Other Intangible Assets" which changed the method of accounting for goodwill and other intangible assets effective December 1, 2001.

/s/ PricewaterhouseCoopers LLP

Miami, Florida
January 29, 2004

SCHEDULE C

CARNIVAL PLC - UK GAAP GROUP FINANCIAL INFORMATION SUMMARISED GROUP PROFIT AND LOSS ACCOUNT

	Eleven months to November 30, 2003		Twelve months to December 31, 2002
	Continuing	Discontinued	

	operations	operations	Total	restated
		(note 3)		(note 2)
US $ millions				
Turnover	1,403.4	1,398.7	2,802.1	2,519.5
Cost of sales before exceptional item	(1,096.7)	(1,008.7)	(2,105.4)	(1,893.9)
Exceptional impairment loss	(50.0)	--	(50.0)	--
	(1,146.7)	(1,008.7)	(2,155.4)	(1,893.9)
Administrative expenses before exceptional costs	(138.5)	(124.9)	(263.4)	(214.8)
Exceptional transaction costs	(30.7)	--	(30.7)	(117.0)
	(169.2)	(124.9)	(294.1)	(331.8)
Total operating profit	87.5	265.1	352.6	293.8
(Loss)/profit on sale of businesses			(2.7)	1.2
Profit on ordinary activities before interest			349.9	295.0
Net interest payable and similar items			(87.0)	(74.0)
Profit on ordinary activities before taxation			262.9	221.0
Taxation			(13.2)	(17.1)
Profit after taxation for				

the period	249.7	203.9
Dividends	(94.2)	(83.2)
	-----	-----
Retained profit for the period	155.5	120.7
	-----	-----
Earnings per share		
Basic earnings per share (in U.S. dollars)*	$1.19	$0.98
Diluted earnings per share (in U.S. dollars)*	$1.19	$0.98
Dividend per share (in U.S. dollars)*	$0.46	$0.40
Weighted average number of shares in issue (in millions)		
-Basic*	209.3	208.0
-Diluted*	210.7	209.0

* Stated after the share consolidation (which took place on completion of the dual listed company ("DLC") transaction with Carnival Corporation on April 17, 2003, in which every 3.3289 shares of Carnival plc were consolidated into 1 share of Carnival plc).

See accompanying notes to the group financial information. This financial information only presents the UK GAAP results of Carnival plc, and does not include the consolidated results of Carnival Corporation.

CARNIVAL PLC - UK GAAP GROUP FINANCIAL INFORMATION SUMMARISED GROUP BALANCE SHEET

	As at November 30, 2003	As at December 31, 2002 restated (note 2)
US $ millions		
Goodwill	141.2	127.1
Ships	5,676.4	4,472.6
Ships under construction	396.9	907.4
Properties and other fixed assets	256.5	249.4
Investments	5.6	16.3
	-------	-------
Total fixed assets	6,476.6	5,772.8
	-------	-------

Current assets		
Stocks	99.0	87.4
Debtors	282.3	225.0
Cash at bank and in hand	186.3	162.1
	567.6	474.5
Creditors: amounts falling due within one year	(1,300.1)	(996.7)
Net current liabilities	(732.5)	(522.2)
Total assets less current liabilities	5,744.1	5,250.6
Creditors: amounts falling due after more than one year	(2,783.7)	(2,516.8)
Provisions for liabilities and charges	(19.1)	(13.7)
Net assets	2,941.3	2,720.1
Equity shareholders' funds	2,941.0	2,719.9
Equity minority interests	0.3	0.2
	2,941.3	2,720.1

See accompanying notes to the group financial information. This financial

information only presents the UK GAAP results of Carnival plc, and does not include the consolidated results of Carnival Corporation.

CARNIVAL PLC - UK GAAP GROUP FINANCIAL INFORMATION SUMMARISED GROUP CASH FLOW STATEMENT

	Eleven months to November 30, 2003	Twelve months to December 31, 2002
US $ millions		
Net cash inflow from operating activities	606.4	576.1
Returns on investments and servicing of finance	(110.7)	(104.0)
Taxation	(21.0)	6.4
Net cash inflow before capital expenditure	474.7	478.5
Capital expenditure		
Purchase of ships	(698.2)	(1,124.1)
Purchase of other fixed **assets**	(35.5)	(32.4)

Purchase of own shares	(7.3)	--
Disposal of other fixed **assets**	2.2	--
	-------	-------
Net cash outflow for capital expenditure	(738.8)	(1,156.5)
	-------	-------
Acquisitions and disposals		
Acquisition of subsidiary	(65.7)	--
Disposal of subsidiaries and long-term investments	6.0	3.1
	-------	-------
Net cash (outflow)/inflow for acquisitions and disposals	(59.7)	3.1
	-------	-------
Equity dividends paid	(62.5)	(85.0)
	-------	-------
Net cash outflow before financing	(386.3)	(759.9)
Financing		
Issue of ordinary share capital	27.8	3.9
Other net cash inflow from financing	388.4	811.4
	-------	-------
Net cash inflow from financing	416.2	815.3
	-------	-------
Increase in cash in the period	29.9	55.4
	-------	-------
Reconciliation to net debt		
Net debt at beginning of period	(2,471.9)	(1,436.4)
Increase in net cash	29.9	55.4
Movements in borrowings	(388.4)	(811.4)
Non-cash movements in borrowings		
Inception of ship leases	--	(129.9)
Amortisation of bond issue costs	(1.7)	(1.9)
Exchange adjustments	(97.0)	(147.7)
	-------	-------
Net debt at end of period	(2,929.1)	(2,471.9)
	-------	-------

The prior year adjustments have no impact on the cash flow as previously reported for the year ended December 31, 2002.

See accompanying notes to the group financial information. This financial information only presents the UK GAAP results of Carnival plc, and does not include the consolidated results of Carnival Corporation.

CARNIVAL PLC - UK GAAP GROUP FINANCIAL INFORMATION RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS

US $ millions	Eleven months to November 30, 2003	Twelve months to December 31, 2002 restated (note 2)
Profit for the period	249.7	203.9
Exchange movements	95.3	44.0
Total recognised gains for the period	345.0	247.9
Dividends	(94.2)	(83.2)
New shares issued	27.8	3.9
Shares to be issued	(57.5)*	10.7
Net increase in shareholders' funds	221.1	179.3
Shareholders' funds at beginning of period (originally $2,629.4 million at January 1, 2002 before deducting prior year adjustments of $88.8 million)	2,719.9	2,540.6
Shareholders' funds at end of period	2,941.0	2,719.9

* Represents outstanding contingent consideration at December 31, 2002 to be settled by the issue of shares but which, following the formation of the DLC, has been paid in cash.

See accompanying notes to the group financial information. This financial information only presents the UK GAAP results of Carnival plc, and does not include the consolidated results of Carnival Corporation.

CARNIVAL PLC - NOTES TO UK GAAP GROUP FINANCIAL INFORMATION

Note 1. Basis of preparation

On April 17, 2003, Carnival Corporation and Carnival plc (formerly known as P&O Princess Cruises plc) completed a dual listed company ("DLC") transaction (the "DLC transaction"), which implemented the Carnival

Corporation & plc DLC structure. The DLC structure combined the businesses of Carnival Corporation and Carnival plc through a number of contracts and amendments to Carnival Corporation's articles of incorporation and by-laws and to Carnival plc's memorandum of association and articles of association. The two companies have retained their separate legal identities and each company's shares continue to be publicly traded on the New York Stock Exchange ("NYSE") for Carnival Corporation and the London Stock Exchange for Carnival plc. In addition, Carnival plc's ADS's are traded on the NYSE. However, the two companies operate as if they were a single economic enterprise. The contracts governing the DLC structure provide that both companies each continue to have separate boards of directors, but the boards and senior executive management of both companies are identical.

In order to provide the Carnival Corporation and Carnival plc shareholders with the most meaningful picture of their economic interest in the DLC formed by Carnival Corporation and Carnival plc (collectively known as "Carnival Corporation & plc"), consolidated financial statements and management commentary of Carnival Corporation & plc have been included in the Carnival Corporation & plc 2003 Annual Report. The consolidated Carnival Corporation & plc financial statements have been prepared under purchase accounting principles whereby the DLC transaction has been accounted for as an acquisition of Carnival plc by Carnival Corporation. Therefore, the consolidated Carnival Corporation & plc financial statements include Carnival plc from April 17, 2003, being the effective date of the acquisition by Carnival Corporation, to November 30, 2003 and Carnival Corporation for the

full year ended November 30, 2003. These consolidated Carnival Corporation &

plc financial statements have been prepared under U.S. GAAP on the basis that

all significant financial and operating decisions affecting the DLC companies are taken on the basis of U.S. GAAP information and consequences.

The standalone Carnival plc UK GAAP financial information is required to

satisfy reporting requirements of the UKLA and does not include the results of

Carnival Corporation. However, the Directors consider that within the DLC

arrangement the most appropriate presentation of Carnival plc's results and

financial position is by reference to the U.S. GAAP financial statements of

Carnival Corporation & plc, which is included in the attached Schedule B.

Except for the accounting policy changes detailed in Note 2, the accounts

for the period ended November 30, 2003 have been prepared using the accounting

policies disclosed in the Annual Report and Accounts for the year ended December 31, 2002.

Note 2. Prior year adjustments on implementation of the Carnival Corporation & plc DLC

Following the completion of the DLC transaction the following accounting

policies were amended so as to conform with those of Carnival Corporation. In

addition Carnival plc changed its accounting reference date to November 30, to

align it with that of Carnival Corporation's. The prior period information is for the twelve months ended December 31, 2002.

(a) Cruise revenues and expenses
Carnival plc's previous accounting policy was initially to record

deposits received on sales of cruises as deferred income and recognise

them, together with revenues from onboard activities and all associated

direct costs of a voyage, on a pro rata basis over the duration of the voyage. Carnival plc's new accounting policy is to recognise these items generally upon completion of voyages with durations of ten days or less and on a pro rata basis for voyages in excess of ten days. The change to the balance sheet is an increase in net current liabilities of $9.5 million at December 31, 2002 with a corresponding reduction in shareholders' funds, and a reduction in 2002's profit of $3.9 million.

(b) Dry-docking costs

Carnival plc's previous accounting policy was to capitalise dry-docking costs, comprising major repairs and replacements, and expense them using the straight-line method through the date of the next scheduled dry-dock, which typically was over two to three years. Carnival plc's new accounting policy is to defer major repairs performed during dry-dock and expense them over one year, being the estimated period of benefit. Replacements during a dry-dock are now capitalised as fixed assets on a component basis and depreciated over their estimated useful lives, with the estimated net book value of assets being replaced written off. The change to the balance sheet is an increase in net current liabilities of $14.9 million at December 31, 2002 with a corresponding reduction in shareholders' funds and a reduction in 2002's profit of $5.0 million.

(c) Marketing and promotion costs

Carnival plc's previous accounting policy was to expense all marketing and promotion costs over the period of benefit, not exceeding one year from the end of the year the cost was incurred. Carnival plc's new accounting policy is to expense all such costs as incurred, except for brochures and media production costs, which are recorded as prepaid

expenses and charged to the profit and loss account as brochures are consumed or upon the first airing of the advertisement. The change to the balance sheet is an increase in net current liabilities of $69.5 million at December 31, 2002 with a corresponding reduction in shareholders' funds and an increase in 2002's profit of $3.8 million.

As a result of these three prior year adjustments, the net effect on Carnival plc's net assets and shareholders' funds as at January 1, 2003 is a reduction of $93.9 million (January 1, 2002 a reduction of $88.8 million). Subsequent to the completion of the DLC transaction results under the old accounting policies were not considered relevant and were therefore not maintained, consequently the impact of these three policy changes on the current period's result is not available (2002 - twelve months net reduction in profit $5.1 million).

Note 3. Post balance sheet event

On December 1, 2003 Carnival Corporation & plc commenced a corporate restructuring involving the transfer within the DLC group of subsidiary companies below Carnival Corporation and Carnival plc. These transactions are being undertaken primarily to facilitate business integration and the flow of funds between affiliated companies.

The principal transactions of the reorganisation, which is expected to be substantially complete by April 2004, are:

* the transfer by Carnival plc to Carnival Corporation of Princess Cruise Lines Limited and a number of related ship owning entities, the companies which operate and own substantially all of Princess Cruises, together with its obligations under public and private U.S. dollar notes and related derivatives; and

* the transfer by Carnival Corporation to Carnival plc of the cruise operations of both Cunard Line Limited, excluding Seabourn Cruise Line, and

Costa Finance S.A., as well as Carnival Corporation's U.S., UK and Mexican

land based operations, including its Alaska and Canadian Yukon tour busines
s.

The consideration for the transfer of assets, liabilities and financia
l

instruments between the two companies was or will be based on fair market v
alues.

Pursuant to these transactions, Princess Cruises is treated as a

discontinued operation in the Carnival plc 2003 Annual Report. Princess

Cruises' turnover for the eleven month period was $1,398.7 million (2002 -

twelve months $1,364.1 million) and operating profit was $265.1 million
(2002 - twelve months $228.2 million).

This series of transactions is effectively a group reconstruction and
Carnival plc will apply merger accounting principles to reflect the

combination with Cunard, Costa and the other assets being acquired from

Carnival Corporation. These transactions do not give rise to a consolidate
d
profit or loss.

END

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Petrofund Energy Trust Reports Financial and Reserve Results for 2003.

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CALGARY, Alberta--(BUSINESS WIRE)--Feb. 18, 2004

Petrofund Energy Trust (AMEX:PTF)(TSX:PTF.UN) is pleased to present its year end financial results for 2003 as well as selected information from its independent engineering reserve report. Attractive commodity prices and successful drilling and acquisition programs all contributed to Petrofund's strong 2003 results.

Key accomplishments in 2003 include:

-- a 67% increase in cash flow to $187.6 million
-- a 22% increase in distributions to $2.09 per unit
-- a 2003 payout ratio of 70%
-- year end debt to cash flow ratio of 0.59
-- a 10% increase in production to 28,418 boepd
-- a 24% reduction per boe in General and Administrative costs
-- an increase in the proved plus probable reserve life index to 11.1 years
-- replacement of 200% of 2003 annual production through acquisitions and development
-- disposition of high cost, low RLI properties for total proceeds of $33.7 million
-- a 3% net increase in reserves after acquisitions, dispositions, revisions and production

Petrofund's financial results for the year ending December 31, 2003 are presented below. Selected information from Petrofund's independent engineering reserve report is also included after the financial results.

HIGHLIGHTS

FINANCIAL HIGHLIGHTS

(thousands of Canadian dollars and units, except per unit amounts)

For the year ended December 31,		2003	2002	Variance
INCOME STATEMENT				
Revenues	$	393,109	$ 270,669	45%
Cash flow (1)	$	187,585	$ 112,570	67%
Cash flow available for distribution (2)	$	150,712	$ 103,095	46%
Cash flow available for distribution per unit(2)				
Before allocation for capital	$	2.96	$ 2.27	30%
Allocation for capital	$	(0.49)	$ (0.20)	(145)%
After allocation for capital	$	2.47	$ 2.07	19%
Cash distributions paid per unit	$	2.09	$ 1.71	22%
Net income	$	85,804	$ 24,379	252%
Net income per unit				
Basic	$	1.41	$ 0.49	188%
Diluted	$	1.40	$ 0.49	186%
UNITS AND EXCHANGEABLE SHARES OUTSTANDING (3)				
Weighted average		61,010	49,922	22%
Diluted		61,153	49,968	22%
At period end		73,628	54,108	36%
BALANCE SHEET				
Working capital (deficit)	$	(30,006)	$ (6,909)	(334)%
Property, plant and equipment and other assets	$	879,633	$ 835,366	5%
Long-term debt	$	110,315	$ 219,218	50%
Unitholder's equity	$	649,240	$ 480,097	35%

MARKET CAPITALIZATION,			
as at December 31 (4)	$1,383,465	$ 587,068	136%
ENTERPRISE VALUE (4)	$1,493,780	$ 806,286	85%
TRUST UNIT TRADING (TSX: PTF.UN)			
High	$ 19.15	$ 13.90	38%
Low	$ 10.69	$ 10.10	6%
Close	$ 18.79	$ 10.85	73%
Volume (units)	53,118	25,820	106%
TRUST UNIT TRADING (AMEX: PTF)			
High	$ 14.73	$ 6.48	127%
Low	$ 6.89	$ 8.78	(22)%
Close	$ 14.46	$ 6.90	110%
Volume (units)	84,319	12,147	594%

(1) Cash flow before net change in non-cash operating working capital balances. Non-GAAP measure, see special notes in the Management Discussion and Analysis.
(2) See Note 12 to consolidated financial statements for details.
(3) See Note 8 to consolidated financial statements for details.
(4) Market capitalization equals units outstanding and issuable for exchangeable shares at December 31, 2003 multiplied by the closing price of the units on that date. Enterprise value equals market capitalization plus long-term debt.

OPERATIONAL HIGHLIGHTS

(thousands of Canadian dollars except per unit amounts)

For the year ended December 31,	2003	2002	Variance
DAILY PRODUCTION			
Oil (bbls)	12,454	11,162	12%
Natural gas (mmcf)	83.3	76.9	8%
Natural gas liquids (bbls)	2,079	1,808	15%
BOE (6:1)	28,418	25,782	10%
Total annual production (mboe)	10,373	9,410	10%
PRODUCTION PROFILE			
Oil	44%	43%	
Natural Gas	49%	50%	
Natural gas liquids	7%	7%	
PRICES			
Oil (per bbl)	$ 37.91	$ 34.68	9%
Natural gas (per mcf)	$ 6.39	$ 3.95	62%
Natural gas liquids (per bbl)	$ 34.66	$ 28.30	22%
BOE (6:1)	$ 37.87	$ 28.77	32%
Operating netback per BOE	$ 20.93	$ 15.46	35%
PROVED PLUS PROBABLE RESERVES (1)			
Crude oil (millions of barrels)	53.4	46.7	14%
Natural gas (billions of cubic feet)	248.7	274.2	(9)%
Natural gas liquids (millions of barrels)	7.2	7.0	3%
Millions of barrels of oil equivalent at 6:1	102.0	99.4	3%

LEASE OPERATING COSTS	$ 91,251	$ 74,774	(22)%
Cost per boe	$ 8.80	$ 7.95	(11)%
GENERAL AND ADMINISTRATIVE COSTS	$ 13,047	$ 15,514	16%
Cost per boe	$ 1.26	$ 1.65	24%

(1) Reserves at December 31, 2003, are based on total proved plus probable company interest reserves prior to royalties as defined in National Instrument 51-101 ("NI 51-101"). Reserve numbers for other years are based on established company interest, (proved plus 50 per cent probable) reserves prior to royalties.

MANAGEMENT DISCUSSION & ANALYSIS

NAME CHANGE AND REVISED TRADING SYMBOL

This is the first annual report that reflects the name change of the Trust to Petrofund Energy Trust ("Petrofund" or the "Trust") from NCE Petrofund. The name change was announced on October 23, 2003, and became effective November 1, 2003. On the same date, the name of the Trust's 100% owned subsidiary was changed to Petrofund Corp. ("PC") from NCE Petrofund Corp. As a result of the name change, the Trust adopted the new trading symbols PTF.UN on the Toronto Stock Exchange and PTF on the American Stock Exchange. The Trust units commenced trading under the new symbols on November 3, 2003.

The name change reflects the restructuring of the Trust. The restructuring began with the internalization of management early in 2003 and the consolidation of the remaining activities in the Calgary office over the year. Petrofund has an experienced and competent team of oil and gas professionals and support groups who have assembled an excellent portfolio of quality assets. This team has been an instrumental part of the significant growth of the entity which had an enterprise value of $1.5 billion as at December 31, 2003.

SPECIAL NOTES

The following discussion and analysis of financial results should be read in conjunction with the consolidated financial statements of the Trust for the fiscal years ended December 31, 2003 and 2002 presented later in this report. This commentary is based on information available to February 15, 2004.

All amounts are stated in Canadian dollars unless otherwise noted. Where amounts and volumes are expressed on a barrel of oil equivalent basis, gas volumes have been converted to barrels of oil at 6,000 cubic feet per barrel (6 mcf/bbl).

Management uses cash flow (before changes in non-cash working capital) to analyze operating performance and leverage. Cash flow as presented does not have any standardized meaning prescribed by Canadian GAAP and may not be comparable with the calculation of similar measures for other entities. Cash flow as presented is not intended to represent operating cash flows or operating profits for the period, nor should it be viewed as an alternative to cash flow from operating activities, net earnings or other measures of financial performance calculated in accordance with Canadian GAAP. All references to cash flow throughout this report are based on cash flow before changes in non-cash working capital.

Reserves at December 31, 2003, are based on total proved plus probable company interest reserves prior to royalties as defined in National Instruments 51-101 ("NI 51-101"). Reserves volumes and values for 2003 have been calculated and disclosed in accordance with this standard. Reserve numbers for other years and previously announced acquisitions for the current year, are based on established company interest (proved plus 50% probable) reserves prior to royalties. Under those definitions, probable reserves were adjusted by a factor to account for the risk associated with their recovery. The Trust previously applied a risk factor of 50% in reporting probable reserves. Under current NI 51-101 reserves definitions, estimates are prepared such that the full proved plus probable reserves are estimated to be recoverable (proved plus probable reserves are

effectively a "best estimate"). The attached reconciliation reflects current probable versus previous risk adjusted (50%) probable reserves reported by the Trust.

FORWARD-LOOKING STATEMENTS

This disclosure includes statements about expected future events and/or financial results that are forward-looking in nature and subject to substantial risks and uncertainties. For those statements, Petrofund claims the protection of the safe harbor for forward-looking statements provisions contained in the U.S. Private Securities Litigation Reform Act of 1995. Petrofund cautions that actual performance will be affected by a number of factors, many of which are beyond its control. These include general economic conditions in Canada and the United States; industry conditions including changes in laws and regulations; changes in income tax regulations; increased competition; and fluctuations in commodity prices, foreign exchange and interest rates. In addition, there are numerous risks and uncertainties associated with oil and natural gas operations and the evaluation of oil and natural gas reserves. As a result, future events and results may vary substantially from what Petrofund currently foresees.

A more complete discussion of the various factors that may affect future results is contained in Petrofund's recent filings with the Securities and Exchange Commission and Canadian securities regulatory authorities.

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make certain judgments and estimates. Changes in these judgments and estimates could have a material impact on the Trust's financial results and financial condition. The Trust has determined that the process of estimating reserves is critical to several accounting estimates. The process of estimating reserves is complex and requires significant judgments and decisions based on available geological, geophysical, engineering and economic data. These estimates may change substantially as additional data from ongoing development and production activities becomes available, and as economic conditions impacting oil and natural gas prices, operating costs, and royalty burdens change. Reserve estimates impact net income through depletion, the provision for site reclamation and abandonment and in the application of the ceiling test, whereby the value of the oil and natural gas assets are subjected to an impairment test. The reserve estimates are also used to asses the borrowing base for the Trust's credit facilities. Revision or changes in the reserve estimates can have either a positive or a negative impact on net income or the borrowing base of the Trust.

2003 HIGHLIGHTS

The Trust paid out cash distributions of $127.3 million or $2.09 per unit, an increase of 22% over the $1.71 per unit paid in 2002.

The Trust's payout ratio for the year was 70% (87% for the fourth quarter).

Net income increased 252% to $85.8 million.

The Trust generated cash flow of $187.6 million, an increase of 67% over 2002.

Production on a boe basis increased 10% to 28,418 boepd.

Average prices were relatively strong, up 32% on a boe basis from the prior year. The Canadian dollar strengthened in the second half of the year more than offsetting the increase in the West Texas Intermediate ("WTI") U.S. oil prices. The average WTI price in the second half of 2003 was up 9% to $30.16 a barrel from the same period in 2002, however, the Canadian par price at Edmonton was down 6% or $2.77 per bbl over the same period.

The internalization of management transaction was completed resulting in the elimination of management fees and lower general and administrative costs.

Petrofund acquired interests in various long-life oil and gas properties for $115.6 million (excluding the non-cash future income tax

adjustment of $4.7 million on the purchase of Solaris Oil and Gas Inc.). The properties added proved plus probable reserves of 19.4 million boe.

Petrofund continued an active development drilling and farmout program, investing $71.4 million on development drilling, facilities and other costs. During the year 254 wells were drilled at an overall success rate greater than 90%. These activities added production at $28,600 per boepd. The combined result of the acquisition and development programs was to add 20.3 million boe's of reserves and replace 200% of 2003 production.

Petrofund ended 2003 with a very strong balance sheet with long-term debt outstanding equivalent to 59% of 2003 cash flow.

The Trust completed two equity offerings, raising net proceeds of $193.4 million.

The Trust had a balanced production profile consisting of 49% gas and 51% oil and liquids.

The Trust reached a milestone with market capitalization exceeding $1.3 billion.

Corporate governance was strengthened including the establishment of Governance, Reserve Audit, and Human Resources and Compensation committees all consisting of independent directors. The Audit committee previously consisted of all independent directors. Petrofund meets all governance guidelines prescribed by the TSX and the AMEX.

Internalization of Management

One of the key achievements in the first half of 2003 was the elimination of the external management contract and all related fees.

At the Annual and Special Meeting held on April 16, 2003, unitholders of the Trust voted over 90% in favour of the proposed internalization of management resolution, and on April 29, 2003, the transaction was closed. As a result of the internalization, NCE Petrofund Management Corp. ("NCEP Management"), the Previous Manager of the Trust and NCE Management Services Inc. ("NMSI"), which employed all of the Calgary-based personnel who provided services to the Trust and PC, became wholly-owned subsidiaries of PC. Effective January 1, 2004 all the Calgary employees became direct employees of PC, the operating company.

As a result of the transaction, all management, acquisition and disposition fees payable to the Previous Manager were eliminated effective January 1, 2003, and the Trust's operations were consolidated in Calgary. To ensure an orderly transition of the services previously provided by NCEP Management through its office in Toronto, PC entered into an agreement with Sentry Select Corp. ("Sentry") to provide certain services to the Trust and PC until December 31, 2003. The cost decreased from $1 million in the first quarter to $500,000 in the second quarter and to $250,000 in each of the third and fourth quarters, after which Sentry no longer provides any services to Petrofund. Sentry was an affiliate of NCEP Management and is a company in which John Driscoll, the Chairman of the Board of Directors, owns a controlling interest.

The elimination of management fees and the reduction in general and administrative costs resulting from the streamlining and consolidation of on-going management in Calgary improved the operating structure of the Trust. The internalization was accretive to Petrofund's net asset value, distributions and cash flow per unit.

The elimination of management fees and the increased management ownership further aligned the interests of the unitholders and management and improved Petrofund's competitiveness for acquisitions as a result of the elimination of acquisition and disposition fees. The completion of the internalization is also expected to enhance the attractiveness of the units to a wider range of potential investors, expand the investor base, and may result in a lower cost of capital.

The cost of the internalization to Petrofund was $30.9 million, consisting of the issue of 1,939,147 exchangeable shares, 100,244 Trust units, and cash of $8.0 million, including $3.4 million to repay indebtedness owing to NCEP Management. Initially, each Exchangeable Share was exchangeable into one Trust unit. The exchange rate is adjusted from

time to time to reflect distributions paid on each Trust unit after the closing date. The purchase price was based on numerous factors, including a fairness opinion by CIBC World Markets, who were retained by a special committee of the Board of Directors formed to consider this transaction and negotiate the terms of the internalization.

CASH DISTRIBUTIONS

Trust unitholders who held their units throughout 2003 received cash distributions of $2.09 per unit as compared to $1.71 per unit in 2002 and $4.24 in 2001. During each of the first two months of 2004, the Trust distributed $0.16 per unit.

The Trust generated cash flow available for distributions of $180.7 million in 2003. A total of $30 million of this cash flow was allocated to capital expenditures during the year in accordance with the Trust's policy to use a portion of the cash flow generated to offset production decline and enhance long-term unitholder returns. The $30 million represents 17% of cash flow for the year. A total of $127.3 million was paid out in distributions representing a payout ratio of 70%. In the fourth quarter, the Trust generated cash flow available for distribution of $41.6 million before deducting $7.5 million of capital and paid out $36.3 million in distributions for a payout ratio of 87%. For a detailed analysis of cash flow available for distribution and distributions paid refer to Note 12 to the Consolidated Financial Statements.

At December 31, 2003, the Trust had $53.5 million available to pay future distributions, capital and other costs, of which $23.6 million was used to pay the January and February 2004 distributions.

RESULTS OF OPERATIONS

PRODUCTION

In accordance with Canadian practice, production volumes and reserves are reported on a working interest basis, before deduction of Crown and other royalties, unless otherwise indicated.

Production volumes averaged 28,418 boe/d, an increase of 10% over average production volumes of 25,782 boe/d in the previous year. The majority of the increase is due to the additional properties purchased for $62 million in the second quarter of 2003, the additional Swan Hills Unit interest purchased in the third quarter of 2003 and the acquisition of NCE Energy Trust on May 31, 2002. Production from the second quarter acquisition is included in this report effective June 1, 2003, and the additional Swan Hills interest is included effective September 1, 2003.

For the years ended December 31,	2003	2002	2001
Daily Production			
Oil (bbls)	12,454	11,162	8,156
Gas (mmcf)	83.3	76.9	67.2
Natural gas liquids (bbls)	2,079	1,808	1,452
Total (boe 6:1)	28,418	25,782	20,810

PRICING & PRICE RISK MANAGEMENT

Revenues from the sale of crude oil, natural gas, and natural gas liquids and sulphur increased 45% to $393.1 million in 2003 from $270.7 million in 2002 due to a 10% increase in production and 32% increase in prices on a boe basis.

Crude oil sales increased to $172.3 million in 2003 from $141.3 million in 2002 due to a 12% increase in production from 11,162 bbl/d in 2002 to 12,454 bbl/d in 2003. The average WTI U.S. oil price increased from $26.08 per bbl in 2002 to $31.04 in 2003 or 19%, however, the Canadian par price at Edmonton increased only 8% from $39.91 per bbl to $43.14 bbl due to the significant strengthening of the Canadian dollar relative to the U.S. dollar, especially in the last half of the year. The average Canadian wellhead price increased from $34.68 per barrel in 2002 to $37.91 per

barrel in 2003. Hedging losses reduced the price by $1.00 per bbl in 2003 and $2.10 per bbl in 2002. About 72% of the Trust's crude production is sold directly to refiners, up from 62% a year ago and nearly double the level of 2001. This reflects Petrofund's strategy of reducing sales to marketers and middlemen to achieve higher levels of security for both credit and the actual physical delivery of the crude. The balance of the crude is delivered to marketers. Crude differentials were relatively stable and tight during 2003 with Petrofund's actual differentials from Edmonton postings before hedging at $4.23/bbl versus $3.16/bbl the previous year. Western Canadian crude differentials for 2004 are expected to be similar to those seen in 2003. Heavy oil differentials, to which Petrofund has little exposure, may be weaker and the bias is for tighter differentials for the lighter and medium sour crudes comprising the bulk of the Trust's portfolio. Petrofund's crude portfolio is over 97% light and medium crudes.

Natural gas sales increased to $194.2 million in 2003 from $110.7 million in 2002 due to an 8% increase in production in addition to a 62% increase in average prices from $3.95 per mcf in 2002 to $6.39 per mcf in 2003 net of a hedging loss of $0.11 per mcf. The monthly AECO price increased from $4.07 per mcf in 2003 to $6.71 per mcf in 2003. Production volumes were 83.3 mmcf/d in 2003 compared to 76.9 mmcf/d in 2002. Petrofund sold 34% of its production in 2003 to aggregators at netback pricing, down slightly from 38% in 2002 and similar to volumes delivered in 2001. The Trust sold the remaining 66% on daily and monthly spot market pricing in Alberta, Saskatchewan and British Columbia.

Sales of natural gas liquids increased to $26.6 million in 2003 from $18.7 million in 2002 as production increased to 2,079 bbl/d in 2003 from 1,808 bbl/d in 2002. The average price increased from $28.30 per barrel in 2002 to $34.66 per barrel in 2003. The majority of the Trust's NGL is sold to two buyers under one-year contract terms at market sensitive pricing. NGL netbacks lagged the recovery in crude oil prices during the year owing to mid-year weakness in natural gas prices. Petrofund expects NGL's to continue to return attractive pricing for 2004 with very strong pricing for condensate.

Crude oil sales accounted for 44% of total production in 2003 (2002 - 43%, 2001 - 39%), while natural gas sales contributed 49% of production in 2003 (2002 - 50%, 2001 - 54%). Natural gas liquid volumes accounted for 7% of total production in all three years. The Trust continues to maintain an excellent balance between oil and gas production.

Sales Prices

Average prices for the year ended December 31,	2003	2002	2001
Oil (1)	$ 37.91	$ 34.68	$ 34.37
Gas (2)	6.39	3.95	5.09
Natural gas liquids	34.66	28.30	32.57
Weighted average (6:1)	$ 37.87	$ 28.77	$ 32.19
(1) The oil price was increased (decreased) per bbl due to hedging	$ (1.00)	$ (2.10)	$ 1.05
(2) The gas price was decreased per mcf due to hedging	$ (0.11)	$ -	$ (0.13)
Production Revenue (millions)			
Oil	$ 172.3	$ 141.3	$ 102.3
Gas	194.2	110.7	125.0
Natural gas liquids	26.6	18.7	17.2
Total	$ 393.1	$ 270.7	$ 244.5

The Trust implemented a formal risk management policy which provides the Risk Management Committee with the ability to use specified price risk management strategies up to 50% of crude oil, natural gas and NGL production including: fixed price contracts; costless collars; the purchase of floor price options; and other derivative financial instruments to reduce price volatility and ensure minimum prices for a maximum of two years beyond the current date. The program is designed to provide price protection on a portion of the Trust's future production in the event of adverse commodity price movement, while retaining significant exposure to upside price movements. In this way the Trust seeks to provide a measure of stability to cash distributions as well as ensure Petrofund realizes positive economic returns from its capital development and acquisition activities.

As at December 31, 2003, Petrofund has hedged 26 mmcf/d of gas and 5,328 bbl/d of crude oil for 2004. The Trust increased its gas hedges for 2004 by 7 mmcf/d and its crude oil hedges by 1,569 bbl/d over the third quarter. Petrofund's 2004 gas hedges include: 18.5 mmcf/d collared between $5.42/mcf-$7.90/mcf and 7.5 mmcf/d fixed at $6.15/mcf. The Trust will lose its floor protection on about 9% of the collared volumes if AECO drops below $4.74/mcf but will receive a premium of $1.06/mcf in this event. Petrofund's 2004 crude hedges include 1,995 bbl/d fixed at $38.59/bbl in the first half and 668 bbl/d fixed at $36.41 in the second half of the year. The Trust has also collared 4,000 bbl/d in 2004 between $31.20/bbl-$36.86/bbl. The Trust will lose its floor protection on 50% of the collared volume in the event WTI averages less than $27.40/bbl ($21.13 US). Under these transactions Petrofund will receive a premium of $3.89/bbl ($3.00 US) to the actual price. For the first quarter of 2005, the Trust has 9.5 mmcf/d of gas hedged under a $5.80/mcf-$8.97/mcf three way collar. At year end, the Petrofund's 2005 crude hedges include 1,000 bbl/d in a three way collar between $31.12/bbl-$37.60/bbl.

Petrofund also fixed the price on approximately 50% of its power consumption at $44.50/MWh for 2004 and 2005 to control future costs. During 2003, the monthly average power costs ranged from $44.47/MWh to $89.80/MWh.

In early January 2004, Petrofund entered into the following additional hedge transactions:

1) 1,000 bbl/d of crude oil was fixed for March-May 2004 at $41.92/bbl;

2) 1,000 bbl/d of crude oil was fixed for November-December 2004 at $37.73/bbl;

3) 2,000 bbl/d of crude oil for 2005 under a three way WTI collar between $34.75 and $43.18/bbl ($26.81-$33.30 US). Under this transaction, if WTI averages less than $30.46 ($23.50 US), Petrofund will lose the floor protection, but will still receive a $4.54/bbl ($3.50 US) premium to the actual price.

The Trust also increased its AECO gas hedges subsequent to year-end by collaring an additional 1.9 mmcf/d between $5.28/mcf and $7.65/mcf for the period April 1, 2004 to October 31, 2004.

All foreign exchange calculations in this section of the report incorporate the Bank of Canada US dollar rate at the close on December 31, 2003, ($1.2965 C$:US$). For a complete listing of all hedge transaction details please see Note 14 to the Consolidated Financial Statements.

Royalties	2003	2002	2001
Royalties (millions)	$ 84.8	$ 50.4	$ 54.7
Average royalty rate (%)	21.6%	18.6%	22.4%
$/boe	$ 8.18	$ 5.36	$ 7.21

Royalties, which include crown, freehold and overrides paid on oil and natural gas production, increased to $84.8 million in 2003 from $50.4 million in 2002, net of the Alberta Royalty Credit. Royalties increased to

21.6% of revenues in 2003 from 18.6% of revenues in 2002 and 22.4% in 2001. The variation in the average rates is mainly due to the fluctuations in natural gas prices as the gas royalty rate changes with natural gas prices.

Expenses	2003	2002	2001
Expenses (millions)			
Lease operating	$ 91.3	$ 74.8	$ 48.2
General & administrative	13.0	15.5	14.4
Management fee	-	4.7	5.3
Net interest	8.7	8.3	7.8
Expenses per boe			
Lease operating	$ 8.80	$ 7.95	$ 6.35
General & administrative	1.26	1.65	1.90
Management fee	-	0.50	0.70
Net interest	0.84	0.88	1.03

Lease Operating

Oil and gas operating expenses increased to $91.3 million in 2003 from $74.8 million in 2002 (2001 - $48.2 million) due to the additional wells on production and the increase in costs on a boe basis. Operating costs on a boe basis increased to $8.80 in 2003 from $7.95 in 2002 (2001 - $6.35).

The most significant contributor to the higher operating costs in 2003 was the increased costs for workover activities. These activities included rate acceleration projects, well repair, facility turnarounds and other facility maintenance work. There are two components to the increased costs. Firstly, costs in general have risen due to high industry activity levels. Secondly, more workover projects were undertaken for production enhancement because the return on these projects is very good in the current product price environment.

GENERAL & ADMINISTRATIVE

General and administrative costs decreased to $13.0 million in 2003 from $15.5 million in 2002 (2001 - $14.4 million). Costs decreased 24% to $1.26 per boe in 2003 from $1.65 per boe in 2002 as a result of the consolidation of all activities in Calgary and the increased production volumes.

MANAGEMENT FEES

No management fees were payable in 2003 and no future fees will be paid due to the internalization of management. Fees of $4.7 million were paid in 2002 to the Previous Manager (2001 - $5.3 million).

INTEREST

Interest expense increased to $8.7 million in 2003 from $8.3 million in 2002 (2001 - $7.8 million), due to the increase in the average loan balance outstanding.

The bank loan outstanding at December 31, 2003, was $109.7 million as compared to $212.3 million at the end of the previous year.

DEPLETION AND DEPRECIATION & PROVISION FOR RECLAMATION AND ABANDONMENT

Depletion and depreciation is provided on the unit-of-production method based on total estimated proved reserves. Depletion and depreciation expense was $113.9 million in 2003 compared to $98.8 million in 2002 (2001 - $68.5 million). The depletion rate per boe increased to $10.98 in 2003 from $10.50 in 2002 (2001 - $9.01). The $0.48 increase in the depletion rate from 2002 to 2003 was mainly due to the negative reserve revisions at the end of 2002. Unproved properties are included in the depletion and

depreciation rate. The provision for reclamation and abandonment per boe in 2003 was $0.60, compared to $0.62 in 2002 (2001 - $0.48).

RECLAMATION & ABANDONMENT RESERVE

At the end of the year, PC had $3.8 million set aside in cash to fund future abandonment costs. This cash fund is increased by $0.075 per boe produced on an ongoing basis. This cash fund is in place to fund significant future reclamation costs, such as the decommissioning of a major facility.

PC is committed to conducting its operations in a safe and environmentally responsible manner and has an established program in place to manage environmental liabilities. The Trust performs well reclamation and abandonments, flare pit remediation work, etc. on a routine basis to proactively address environmental concerns. Petrofund's activities in this area in 2003 were significant as $4.7 million was spent on these types of projects. This compares to $2.2 million in 2002 and $0.4 million in 2001. PC expects to spend a further $3 million on reclamation and abandonment work in 2004.

NET INCOME

Net income increased to $85.8 million, up 252% from the $24.4 million reported in 2002 (2001 - $54.0). The increase was mainly due to the 35% improvement in operating netbacks as prices were up 32% on a boe basis. In addition, production was up 10% over the prior year.

Net income for the year ended December 31, 2003, was impacted by the costs of the internalization of the management contract and the reduction of income taxes for the decrease in future income tax rates. Net income was reduced by $30.9 million for management internalization costs and increased by $36.7 million for future income tax reductions.

QUARTERLY FINANCIAL DATA

($millions, except per Unit amounts)	Net Oil and Natural Gas Sales(1)	Net Income	Net income per Unit (2) Basic	Diluted
2003				
First quarter	$ 84.9	$ 32.2	$ 0.59	$ 0.59
Second quarter	74.8	15.1	0.26	0.26
Third quarter	73.4	14.9	0.23	0.23
Fourth quarter	75.2	23.6	0.33	0.33
	$ 308.3	$ 85.8	$ 1.41	$ 1.40
2002				
First quarter	$ 42.7	$ 0.9	$ 0.02	$ 0.02
Second quarter	53.1	8.5	0.17	0.17
Third quarter	55.8	9.6	0.18	0.18
Fourth quarter	68.6	5.4	0.10	0.10
	$ 220.2	$ 24.4	$ 0.49	$ 0.49
2001				
First quarter	$ 54.4	$ 26.3	$ 1.19	$ 1.19
Second quarter	46.9	16.4	0.60	0.60
Third quarter	45.4	7.7	0.20	0.20
Fourth quarter	43.0	3.6	0.09	0.09
	$ 189.7	$ 54.0	$ 1.71	$ 1.71

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(1) Net after royalties

(2) Net income per unit numbers are calculated quarterly and therefore do not add.

Discussion of Results for the Fourth Quarter of 2003

Production for the fourth quarter of 2003 was 29,211 boe/d as compared to 27,362 boe/d for the same period in the prior year. Oil was up 13% from 12,096 boe/d to 13,645 boe/d. Natural gas was up marginally to 80.3 mmcf/d from 79.9 mmcf/d and natural gas liquids increased to 2,185 boe/d from 1,946 boe/d. Oil revenues increased to $44.0 million from $40.6 million due to the increase in volumes as the oil price decreased to $35.06 per bbl from $36.48 per bbl. Natural gas revenue was up to $43.1 million from $37.9 million mainly due to the natural gas price which increased 13% from $5.15 per mcf to $5.84 per mcf. Revenues from natural gas liquids increased to $6.9 million from $6.0 million due to volumes and prices. The average price was $34.46 per bbl in the fourth quarter of 2003, as compared to $33.34 per bbl in the fourth quarter of 2002.

Royalties increased from $15.8 million in 2002 to $19.0 million in 2003. Royalties were 19% of revenue in the fourth quarter of 2002 and 20% in the same period in 2003, mainly due to the increased natural gas prices.

Operating costs increased to $24.8 million in 2004 from $21.3 million in 2003, due to the additional wells on production and a general increase in costs experienced by the oil and gas industry.

General and administrative costs decreased from $3.6 million, or $1.43 per boe, in the fourth quarter of 2002 to $2.9 million or $1.10 per boe for the same period in 2003.

Depletion and site reclamation and abandonment expenses increased from $28.6 million in 2002 to $33.7 million in 2003 or $1.20 per boe.

Income before income taxes was $11.4 million in the fourth quarter of 2003 as compared to $10.2 million in the fourth quarter of 2002. Net income, however, was up to $23.6 million from $5.4 million due to a future income tax recovery in 2003 of $12 million as compared to a future tax expense of $5.0 million in 2002. The future tax liability at December 31, 2002 included a provision for income taxes for entities that were acquired by the Trust. These entities were under audit at the time and the CCRA (Canada Customs and Revenue Agency) had made large proposed adjustments. The Trust was successful in having these adjustments reversed to a minimal amount. As a result, the Trust has taken the provision back into income in 2003.

CAPITAL EXPENDITURES

Acquisitions

During the year, PC incurred $115.6 million for property acquisitions, excluding the non-cash future tax adjustment of $4.7 million recognized on the Solaris Oil and Gas Inc. ("Solaris") acquisition, and acquired 19.4 million boe of Established Reserves. The properties were heavily weighted to oil and had a reserve life index of 14.4 years.

Effective January 1, 2003, PC acquired 100% of the outstanding common share of Solaris, and on February 7, 2003, amalgamated Solaris into PC. PC paid $7.4 million in cash, and assumed debt and negative working capital of $1.2 million, for a total cost of the oil and gas properties of $8.6 million. The acquisition added 720,000 boe of Established Reserves and approximately 200 boe/d of production.

In the second quarter of 2003, PC closed the acquisition of a diverse group of oil and natural gas properties for $61.7 million after adjustment. The properties added Established Reserves of 9.7 million boe as estimated by the independent engineering firm, Gilbert Laustsen Jung Associates Ltd. At the time of acquisition, production from the properties was approximately 2,300 boe/d of which 42% was natural gas. Production and cash flow has been included in this report effective from June 1, 2003. The properties contained a large percentage of unit production, and had a reserve life index on an Established basis of 11.6 years.

On August 21, 2003, PC purchased a 7.22% interest in Swan Hills Unit #1 for $37.1 million from a private Canadian company. This acquisition increased PC's interest in the unit, bringing PC's total interest in the unit to 9.87%. This acquisition added 8.5 mmboe of Established Reserves and approximately 1,100 boe/d of production. The Established reserve life index of the property was over 20 years.

Finding & Development Costs

During the year PC incurred $71.4 million on drilling and development activities as compared to $40.8 million in 2002. A total of 214 wells were drilled, of which 115 were gas, 84 oil and 15 dry and abandoned for an overall success rate of 93%. These activities added 2,500 boepd of production at an average cost of $28,600 per boepd and offset more than half of the decline in existing production.

Farmout Activities

During 2003, Petrofund entered into farmout agreements with various industry partners which resulted in 40 wells being drilled in 2003 on Petrofund's undeveloped land base. This drilling yielded 32 natural gas wells, 3 oil wells and 5 abandoned wells.

Although terms are slightly different for each farmout, they are generally structured such that Petrofund is carried for the costs of each well and receives a gross overriding royalty before payout of such costs and an after payout working interest for each well which generally equates to 50% of it pre-farmout interest.

Disposition of Properties

During 2003, Petrofund disposed of approximately 5 million boe of Established Reserves for $33.5 million. Eighty percent of these reserves were sold as a package of non-core east central Alberta properties marketed publicly late in the year. All of the properties disposed of were non-core to Petrofund's ongoing operations, had high operating costs and high decline rates. These dispositions are an integral part of Petrofund's ongoing portfolio management process.

A summary of capital expenditures for the last three years is as follows (in millions):

For the years ended December 31,	2003	2002	2001
Property acquisitions (1)	$ 115.6	$ 218.5	$ 222.4
Property dispositions	(33.5)	(30.0)	(3.7)
Net acquisitions	82.1	188.5	218.7
Finding & development costs:			
Land & seismic	2.5	2.8	2.1
Drilling & completion	42.5	22.2	17.0
Well equipping	7.9	6.7	2.1
Tie-ins	5.2	2.7	2.2
Facilities	8.4	3.2	3.5
Other	4.9	3.2	-
Total	71.4	40.8	26.9
Total net capital expenditures	$ 153.5	$ 229.3	$ 245.6

(1) The property acquisition totals exclude non-cash future income tax adjustments for the difference between the cost and tax bases of assets acquired by way of corporate acquisitions.

DEBT

The borrowing base was increased to $265 million, in conjunction with the closing of the second quarter 2003 property acquisition. As at

December 31, 2003, the amount outstanding on the credit facility was $110 million with $155 million available to finance future activities.

The revolving period on the syndicated facility was scheduled to end on May 30, 2003; however, it has been extended for an additional 364-day period ending May 28, 2004.

WORKING CAPITAL

The working capital deficit was $30 million at December 31, 2003, an increase of $23.1 from the $6.9 million deficit at the end of the prior year. The primary reason for this change is a corresponding increase in distributions payable to unitholders of $23 million. This amount represents the cash flow available for distribution generated during the year in excess of distributions paid.

LIQUIDITY AND CAPITAL RESOURCES

Total long-term debt and capital leases decreased $108.9 million from $219.2 million at December 31, 2002 to $110.3 million at the end of the current year.

The major changes in total long term debt were due to:	$000's
Net proceeds from the May and December equity issues	$ 193.4
Proceeds received from the exercise of options	20.5
Proceeds received from the sale of properties	33.5
Increases in working capital deficit	23.1
Cash flow available for distributions in excess of distributions paid	23.4
Property acquisitions	(115.6)
Expenditures on oil and gas properties	(71.4)
Miscellaneous	2.0
	$ 108.9

Capitalization Analysis

($ thousands, except per unit and percent amounts)	2003	2002	2001
Working capital (deficiency)	$ (30,006)	$ (6,909)	$ (20,564)
Bank debt	109,707	212,253	128,783
Capital lease obligation	608	6,965	16,168
Net **debt obligation**	$ 140,321	$ 226,127	$ 165,515
Units outstanding and issuable for exchangeable shares	73,628	54,108	41,916
Market Price at December 31,	$ 18.79	$ 10.85	$ 11.97
Market capitalization	$ 1,383,465	$ 587,069	$ 501,731
Total capitalization	$ 1,523,786	$ 813,196	$ 667,246
Net debt as a percentage of total capitalization	9.2%	27.8%	24.8%
Cash flow	$ 187,585	$ 112,570	$ 110,176
Net debt to cash flow	0.7:1.0	2.0:1.0	1.5:1.0

Long-term debt will increase in 2004 due to the capital expenditure program which is expected to be in the $60 million range. If the Trust is successful in completing one or more significant acquisitions in 2004 these

would be financed by further utilization of the credit facility or a combination of additional bank borrowing and a possible equity issue of treasury units.

UNITHOLDERS' EQUITY

The Trust had 72,688,577 trust units outstanding at December 31, 2003, compared to 54,108,420 trust units at the end of 2002. In April 2003, 1,939,147 exchangeable shares and 100,244 Trust units were issued in connection with the internalization transaction. During the year, 906,635 Exchangeable Shares were converted to 1,000,000 Trust units and 181,041 were redeemed for cash leaving 851,471 exchangeable shares outstanding at year end which can be converted, at the option of the unitholder into 939,147 trust units. The weighted average number of trust units outstanding including those issuable on the exchange of exchangeable shares, was 61,010,105 trust units for 2003 as compared to 49,921,523 for 2002.

During 2003, the Trust completed two equity offerings. In May 2003, the Trust issued 9.2 million units at a price of $10.60 per unit for net proceeds of $92.3 million. In December 2003, 6.6 million units were issued at a price of $16.20 per unit for net proceeds of $101.1 million.

During the year, 1,673,404 options were exercised for the same number of trust units generating proceeds of $20.5 million. (For complete details of options exercised and outstanding at the end of the year refer to note 11 of the Consolidated Financial Statements).

Under the Distribution Reinvestment Plan ("DRIP") unitholders can elect to receive distributions or make optional cash payments to acquire trust units from treasury or in the open market. Under the DRIP plan 316,785 trust units were issued at an average price of $13.21 for total proceeds of $4.2 million. In 2002, 288,981 units were issued under the DRIP plan at an average price of $12.16 per trust unit.

TAXES

Current taxes consist of the Federal Large Corporations Tax and some minor amounts relating to income taxes of corporate entities acquired. The Federal Large Corporations Tax is based primarily on the debt and equity balances of PC at the end of the year. The Federal Large Corporations Tax rate is proposed in the Federal Budget of 2003 to be reduced in stages over a period of five years so that by 2008, the tax will be eliminated.

Capital taxes of $2.5 million in 2003 and $2.1 million in 2002 are primarily the Saskatchewan Capital Tax and Resource Surcharge, which is based upon Saskatchewan gross revenues.

Future income tax liabilities arise due to the differences between the tax basis of PC's assets and their respective accounting carrying cost. Future income taxes were increased by $4.7 million due to the **purchase** of Solaris. This liability arose as the **purchase** price of Solaris's **assets** was in excess of its tax pools. In the Trust's structure, payments are made between PC and the Trust which thereby transfers both income and future tax liability to the individual unitholders. Accordingly, it is the opinion of management that no cash income taxes will be paid by PC in the future and, as such, the future income tax liability recorded on the balance sheet will be recovered through earnings over time. Future income tax recoveries of $44.5 million in 2003 and $14.3 million in 2002 have resulted in a remaining future income tax liability of $77.0 million at December 31, 2003. The future income tax liability was reduced by approximately $36.7 million to reflect reductions in the Federal and Alberta income tax rates in 2003.

Cash distributions paid to unitholders resident in Canada or the United States have differing tax consequences depending on each unitholder's circumstances. The Trust sets out some brief comments regarding the taxability of the distributions but does not intend to provide legal or tax advice. Unitholders or potential investors should seek their own legal or tax advice in this regard.

Generally, Canadian unitholders include in their income the portion of the distribution that is taxable income earned by the Trust. The portion that is a return of capital reduces the adjusted cost base of the Trust

unit of the unitholder. In 2003, 51.223% of distributions paid to unitholders was ordinary income and 48.777% was a return of capital.

Generally, United States unitholders include in their income the portion of the distribution that is taxable income earned by the trust. Such amount is considered a dividend for U.S. purposes and is subject to Canadian withholding tax. The portion that is a return of capital and not taxable reduces the tax basis of the Trust unit. In 2003, 83.346% of distributions to United States unitholders was dividend income and 16.654% was a return of capital.

BUSINESS RISKS

The success of the Trust in meeting its objective of stable distributions over the long term depends mainly on management's ability to:

1) Identify and acquire oil and gas properties and/or companies at prices that add value to the Trust.

2) Cost effectively add or extend reserves with internal development and drilling or farmouts.

3) Manage and control costs.

There are numerous factors beyond management's control that have a major influence on distribution levels including product prices, unforeseen production declines and cost increases from major suppliers. (A detailed assessment of risk factors and offsetting strategies appears elsewhere in this report).

Below is a table that shows sensitivities to pre-hedging cash flow as a result of product price and operational changes. The table is based on actual 2003 prices received and production volumes of 27,000 boepd. These sensitivities are approximations only and are not necessarily valid at other price and production levels. As well, hedging activities can significantly affect these sensitivities.

Sensitivity Analysis

	Change	$000's	$/unit per year
Price per barrel of oil(1)	$ 1.00 U.S.	$ 5,331	$ 0.072
Price per mcf of natural gas(1)	$ 0.25 Cdn.	$ 5,585	$ 0.076
US/Cdn exchange rate	$ 0.01	$ 2,650	$ 0.036
Interest rate on debt ($125 million)	1%	$ 1,250	$ 0.017
Oil production volumes(1)	100 bbl/day	$ 1,131	$ 0.015
Gas production volumes(1)	1 mmcf/day	$ 1,784	$ 0.024

(1) After adjustment for estimated royalties.

OUTLOOK FOR 2004

The level of cash flow for 2004 will be affected by oil and gas prices, the Canadian - US dollar exchange rate and the Trust's ability to add reserves and production in a cost effective manner. Both product prices and the exchange rate showed significant volatility in 2003 and this trend is expected to continue in 2004. The acquisition market is expected to continue to be active and supply should increase with the recent announcement by three large producers of their intention to dispose of their Canadian properties in 2004. Nevertheless, competition for these assets is expected to be fierce due to increased demand resulting from the increasing number of oil and gas companies that have converted to a trust structure. We expect prices for quality, long life assets to be at or near record levels. Petrofund expects to be an active participant in this market but success will be tempered by a commitment to maintain historic discipline and bid only at levels consistent with the best long term interest of our unitholders.

Acquisition activities will be complemented by an extensive drilling and farmout program that will be conducted on our existing land base.

Although product prices have remained at high levels, the strengthening of the Canadian dollar in the second half of 2003

significantly moderated the net effect of these prices on Petrofund's cash flow. We expect the Canadian dollar to remain very strong in the short term with a possible decrease toward the end of 2004.

Petrofund pursues a well defined risk management program to help offset the effect of price fluctuations. This program utilizes collars as the main hedging tool but Petrofund also enters into fixed price transactions when commodity prices approach historic highs. To date, the Trust has not entered into any currency related transactions. A discussion of the risk management strategies and hedged position appears elsewhere in this report.

CONTRACTUAL OBLIGATIONS

PC has the following long-term commitments for the years indicated:

(thousands of dollars)	2004	2005	2006	2007	2008
Capital leases (Note 6)	$ 0.4	$ 0.6	$ -	$ -	$ -
Office lease	1.1	0.8	-	-	-
Processing & transportation agreement	1.8	1.8	2.0	2.1	2.2
CO_2 purchases	3.9	4.7	4.1	3.5	3.3
	$ 7.2	$ 7.9	$ 6.1	$ 5.6	$ 5.5

(1) The amount increases to $2,223 in 2008 and then decreases to $1,474 in 2019 at which time it expires.

OFF-BALANCE SHEET ARRANGEMENTS/ VARIABLE INTEREST ENTITIES

The Trust has no off-balance sheet arrangements or variable interest entities.

IMPACT OF NEW CANADIAN ACCOUNTING PRONOUNCEMENTS

In September 2002, the CICA approved Section 3063, "Impairment of Long-Lived Assets" (S.3063). S.3063 establishes standards for the recognition, measurement and disclosure of the impairment of long-lived assets, and applies to long-lived assets held for use. An impairment loss is recognized when the carrying amount of a long-lived asset is not recoverable and exceeds its fair value. The new Section is effective for fiscal years beginning on or after April 1, 2003. The application of the impairment test for companies following the full cost method of accounting for oil and natural gas activities has been included in Accounting Guideline 16, "Oil and Gas Accounting - Full Cost" AcG-16 issued in September 2003. The new guideline limits the carrying value of oil and natural gas properties to their fair value. The fair value is equal to estimated future cash flows from proved and risked probable reserves using future price forecasts and costs discounted at a risk-free rate. This differs from the current cost recovery ceiling test that uses undiscounted cash flows and constant prices and costs less general and administrative and financing costs. There is no write-down of the Trust's oil and gas royalty and property interests under either method at December 31, 2003. AcG-16 also adopted the reserve evaluation and disclosure requirements of NI 51-101 which have been followed in the preparation of this report.

In December 2001, the Canadian Institute of Chartered Accountants (CICA) issued Accounting Guideline 13, "Hedging Relationships" (AcG-13) originally effective for fiscal years commencing on or after July 1, 2002. Implementation was then postponed to the fiscal years commencing on or after July 1, 2003. AcG-13 established certain conditions for when hedge accounting may be applied. If hedge accounting is not applied, the fair values of derivative financial instruments are recorded as an asset or a liability on the balance sheet. As the guideline is effective for fiscal years beginning on or after July 1, 2003, Petrofund will be adopting the guideline effective January 1, 2004. Petrofund enters into numerous derivative financial instruments to reduce price volatility and establish minimum prices for a portion of its oil and natural gas production. These

contracts are effective economic hedges, however, a number do not qualify for hedge accounting due to the very detailed and complex rules outlined in AcG-13. Petrofund has elected to use the fair value method of accounting for all derivative transactions as we believe it would be confusing to the reader if the Trust were to use hedge accounting for some of its hedging contracts and fair value accounting for others. Also the additional costs to use hedge accounting would be significant as detailed documentation requirements must be met and each individual contract would need to be analyzed to determine which method of accounting to use. Effective January 1, 2004, Petrofund will record the fair value of the derivative financial instruments as at December 31, 2003, in the amount of $6.8 million as a liability on the balance sheet. The change in the fair value from period to period will be recorded in the income statement on a separate line as unrealized gains/losses. This line item will also include realized gains and losses on the derivative financial instruments which currently are recorded in oil and gas sales.

In December 2002, the CICA approved Section 3110, "Asset Retirement Obligations" which requires liability recognition for retirement obligations associated with our property, plant and equipment. The obligations are initially measured at fair value, which is the discounted future value of the liability. The fair value is capitalized as part of the cost of the related assets and amortized to expense over their useful lives. The liability accretes until the retirement obligations are settled. S.3110 is effective for fiscal years beginning on or after January 1, 2004. The accrued reclamation and abandonment liabilities on the balance sheet which have been calculated on a unit of production basis will be reversed January 1, 2004. Oil and gas properties will be increased and a liability set up for the amount calculated under the new standard. In 2004 the accounting will follow the new standard and the comparative numbers for 2003 and prior periods will be restated.

The impact of this standard will be to increase oil and gas royalty and property interests on the balance sheet by $18.6 million at December 31, 2003, and by $18.5 million at December 31, 2002. The accrued reclamation and abandonment liability (asset retirement obligation) will increase to $34.4 million at December 31, 2003, from $16.8 million and the liability at December 31, 2002 will increase to $34.5 million from $15.3 million. The effect on the income statement will be to increase (decrease) net income before income taxes by $ 1.5 million in 2003, (2002 - $1.1 million, 2001 - $(0.9) million).

Effective March 31, 2004, the Trust and all reporting issuers in Canada will be subject to new disclosure requirements as per National Instrument 51-102 "Continuous Disclosure Obligations". This new instrument is effective for fiscal years beginning on or after January 1, 2004. The Instrument proposes shorter reporting periods for filing of annual and interim financial statements, MD&A and the Annual Information Form ("AIF"). The Instrument also proposes enhanced disclosure in the annual and interim financial statements, MD&A and AIF. Under this new instrument, it will no longer be mandatory for the Trust to mail annual and interim financial statements and MD&A to unitholders, but rather these documents will be provided on an "as requested" basis. The Trust continues to assess the implications of this new instrument which will be implemented in 2004.

Other accounting standards issued by the CICA during the year ended December 31, 2003, are not expected to impact the Trust at this time.

CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. The Trust's principal executive officer and its principal financial officer, after evaluating the effectiveness of the Trust disclosure controls and procedures (as defined in U.S. Exchange Act Rules 13a - 14(C) and 15d - 14(C)) as of a date within 90 days prior to the filing date of this annual report, have concluded that, as of such date, the Trust's disclosure controls and procedures were adequate and effective to ensure that material

information relating to the Trust and its subsidiaries would be made known to them by others within those entities.

Changes in internal controls. There were no significant changes in the Trust's internal controls or in other factors that could significantly affect the Trust's internal controls subsequent to the date of their evaluation nor were there any significant deficiencies or material weaknesses in the Trust's internal controls. As a result, no corrective actions were required or undertaken.

STATEMENT OF CORPORATE GOVERNANCE

Petrofund adheres to all required regulatory and security commission guidelines as required by the TSX and the AMEX at December 31, 2003. This has resulted in Petrofund's acceptance of a 'best practices' corporate governance structure. To this end, four sub-committees of the Board, all composed of independent directors, act in the best interests of the Trust. Additional information about the board and the committee compositions are detailed in this annual report and within Petrofund's annual information form.

Consolidated Balance Sheet
(unaudited) (thousands of dollars)

As at December 31,	2003	2002
Assets		
Current assets		
Cash	$ 2,182	$ -
Accounts receivable	48,268	41,953
Due from affiliates	-	164
Prepaid expenses and deferred charges	10,036	10,090
Total current assets	60,486	52,207
Reclamation and abandonment reserve (Note 7)	3,779	3,001
Oil and gas royalty and property interests, at cost less accumulated depletion and depreciation of $468,208 (2002 - $354,309) (Notes 2 and 3)	879,633	835,366
	$ 943,898	$ 890,574
Liabilities and unitholders' equity		
Current liabilities		
Bank overdraft	$ -	$ 1,572
Accounts payable and accrued liabilities	36,684	22,007
Payable to affiliates (Note 4)	-	2,168
Current portion of capital lease obligations (Note 6)	356	3,304
Distributions payable to Unitholders	53,452	30,065
Total current liabilities	90,492	59,116
Long-term debt (Note 5)	109,707	212,253
Capital lease obligations (Note 6)	608	6,965

Future income taxes (Notes 2 and 15)	77,005	116,845
Accrued reclamation and abandonment costs	16,846	15,298
Total liabilities	294,658	410,477
Unitholders' equity (Notes 8 and 9)	649,240	480,097
	$ 943,898	$ 890,574

Signed on behalf of Petrofund Energy Trust by Petrofund Corp.:

Jeffery E. Errico, Director   James E. Allard, Director

The accompanying notes to consolidated financial statements are an integral part of this consolidated balance sheet.

Consolidated Statement of Operations
(unaudited) (thousands of dollars)

For the years ended December 31,	2003	2002	2001
Revenues			
Oil and gas sales	$ 393,109	$ 270,669	$ 244,512
Royalties, net of incentives	(84,804)	(50,427)	(54,746)
	308,305	220,242	189,766
Expenses			
Lease operating	91,251	74,774	48,237
Management fee (Note 4)	-	4,728	5,307
Interest on long-term debt (Note 5)	8,748	8,291	7,806
General and administrative (Note 4)	13,047	15,514	14,436
Capital taxes	2,454	2,137	1,719
Depletion and depreciation	113,899	98,777	68,453
Provision for reclamation and abandonment	6,199	5,856	3,680
Internalization of management contract (Note 9)	30,850	-	-
	266,448	210,077	149,638
Net income before provision for income taxes	41,857	10,165	40,128
Provision for (recovery of) income taxes (Note 15)			
Current	569	38	1,701
Future	(44,516)	(14,252)	(15,561)
	(43,947)	(14,214)	(13,860)

Net income	$ 85,804	$ 24,379	$ 53,988

Net income per trust unit (Notes 2 and 16)			
Basic	$ 1.41	$ 0.49	$ 1.71
Diluted	$ 1.40	$ 0.49	$ 1.71

Consolidated Statement Of Unitholders' Equity
(unaudited) (thousands of dollars)

For the years ended December 31,	2003	2002	2001
Balance, beginning of year	$ 480,097	$ 398,702	$ 136,812
Units issued, net of issue costs (Note 8)	226,325	154,460	318,548
Exchangeable shares issued/converted to Trust units (Note 10)	10,518	-	-
Redemption of exchangeable shares (Note 10)	(2,792)	-	-
Net income	85,804	24,379	53,988
Distributions accruing to Unitholders (Note 12)	(150,712)	(97,444)	(110,646)
Balance, end of year	$ 649,240	$ 480,097	$ 398,702

Consolidated Statement of Cash Flows
(unaudited) (thousands of dollars)

For the years ended December 31,	2003	2002	2001
Cash provided by (used in):			
Operating activities			
Net income	$ 85,804	$ 24,379	$ 53,988
Add items not affecting cash:			
Depletion and depreciation	113,899	98,777	68,453
Provision for reclamation and abandonment	6,199	5,856	3,680
Future income taxes	(44,516)	(14,252)	(15,561)
Actual abandonment costs incurred (Note 7)	(4,651)	(2,190)	(384)
Internalization of management contract (Note 9)	30,850	-	-
Cash flow from operating activities	187,585	112,570	110,176
Net change in non-cash operating working capital balances	6,410	(30,938)	18,334

Cash provided by operating activities	193,995	81,632	128,510
Financing activities			
Bank loan	(102,546)	83,470	14,216
Distributions paid	(127,325)	(85,218)	(126,883)
Redemption of exchangeable shares	(2,792)	-	-
Capital lease repayments	(9,305)	(11,366)	(2,629)
Issuance of trust units (Note 8)	214,002	55,821	161,409
Advances to affiliates (Note 4)	-	948	-
Cash provided by (used in) financing activities	(27,966)	43,655	46,113
Investing activities			
Reclamation and abandonment reserve (Note 7)	(776)	(706)	(447)
Acquisition of property interests	(186,956)	(158,516)	(177,729)
Proceeds on disposition of properties	33,466	30,019	3,736
Cash acquired on acquisition (Note 3b)	-	427	-
Internalization of management contract (Note 9)	(8,009)	-	-
Cash used in investing activities	(162,275)	(128,776)	(174,440)
Net change in cash	3,754	(3,489)	183
Cash (bank overdraft), beginning of year	(1,572)	1,917	1,734
Cash (bank overdraft), end of year	$ 2,182	$ (1,572)	$ 1,917
Interest paid during the year	$ 8,885	$ 8,016	$ 7,806
Income taxes paid during the year	$ 842	$ 1,281	$ 1,065

The accompanying notes to consolidated financial statements are an integral part of these consolidated statements.

Notes to consolidated financial statements

December 31, 2003, 2002 and 2001 (Unaudited)

1. ORGANIZATION

Petrofund Energy Trust ("Petrofund" or the "Trust") is an open-ended investment trust created under the laws of the Province of Ontario pursuant to a trust indenture, as amended from time to time (the "Trust Indenture"), between Petrofund Corp. ("PC") and Computershare Trust Company of Canada (the "Trustee"). Active operations commenced March 3, 1989. The beneficiaries of the Trust are the holders of the trust units ("Unitholders").

PC, a wholly-owned subsidiary of the Trust, acquires oil and gas properties for its own account and sells a royalty interest (the "Royalty") to the Trust. The Royalty acquired from PC effectively transfers substantially all of the economic interest in the oil and gas properties to the Trust. The Trust is entitled to 99% of the production revenue from properties purchased by PC, less operating costs, general and administrative expenses, management fees (prior to 2003), debt service charges (including principal and interest) and taxes payable by PC.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements have been prepared by the management of PC following Canadian generally accepted accounting principles. The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingencies at the date of the

financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimated. The following significant accounting policies are presented to assist the reader in evaluating these consolidated financial statements.

(a) Basis of consolidation

The consolidated financial statements include the accounts of the Trust and its wholly-owned subsidiaries, PC, 1518274 Ontario Ltd., NCE Management Services Inc. ("NMSI"), which employed all of the personnel who provided services to the Trust, and NCE Petrofund Management Corp. ("NCEP Management", the "Previous Manager") collectively, the "Subsidiaries". NMSI and NCEP Management were acquired to effect the internalization of management and the shares of 1518274 Ontario Limited are exchangeable into trust units. (See Notes 9 and 10)

(b) Oil and gas royalty and property interests

Oil and gas royalty and property interests are accounted for using the full cost method of accounting whereby all costs of acquiring oil and gas royalty and property interests and equipment are capitalized. General and administrative costs and interest are not capitalized.

The provision for depletion and depreciation and the provision for site reclamation and abandonment costs are computed using the unit-of-production method based on the estimated gross proved oil and gas reserves. Proceeds on sale or disposition of oil and gas royalty and property interests are credited to oil and gas royalty and property interests, unless this results in a change in the depletion and depreciation rate by 20% or more, in which case a gain or loss is recognized in the consolidated statement of operations. The provision for reclamation and abandonment costs is accumulated as a long-term liability, which is reduced as actual expenditures are made.

The carrying value of the oil and gas royalty and property interests, net of accumulated depletion and depreciation, accrued reclamation and abandonment costs and future income taxes is limited to an amount equal to the estimated future net revenue, net of production-related general and administrative costs, reclamation and abandonment costs, and income taxes. Future net revenue was calculated using yearend oil and gas prices and costs.

Effective January 1, 2004, the carrying value of the oil and gas royalty and property interests is limited to their fair value determined by the expected discounted future revenue from the properties.

Distributions payable to Unitholders

Distributions payable to Unitholders are equal to amounts received or receivable by the Trust on the cash distribution date. Income earned, but not received, is distributed on the cash distribution date following receipt.

(c) Future income taxes

The Trust follows the liability method of accounting for income taxes. Under this method, income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements of the Subsidiaries and their respective tax bases, using enacted income tax rates. The effect of a change in income tax rates on future tax liabilities and assets is recognized in income in the period in which the change occurs. Temporary differences arising on acquisitions result in future income tax assets or liabilities.

The Trust is a taxable entity under the Income Tax Act (Canada) and is taxable only on income that is not distributed or distributable to the Unitholders. As the Trust distributes all of its taxable income to the Unitholders and meets the requirements of the Income Tax Act (Canada) applicable to the Trust, no provision for future income taxes in the Trust has been made.

(d) Net income per trust unit

Basic net income per trust unit is computed by dividing net income by the weighted average number of trust units outstanding for the period.

Diluted per unit amounts reflect the potential dilution that would occur if options to issue trust units were exercised and trust units were issued. The treasury stock method is used to determine the effect of dilutive instruments.

(e) Hedging activity

The Trust uses derivative instruments to reduce its exposure to commodity price fluctuations. Gains and losses on contracts, all of which constitute effective hedges, are deferred and recognized as a component of the price of the related transaction.

(g) Trust unit incentive plan

A Trust Unit Incentive Plan (the "Unit Incentive Plan") was established authorizing the issuance of options to acquire Trust units to directors, senior officers, employees and consultants of NCEP, Management, NCE Petrofund Advisory Corp., NMSI and certain other related parties, all of whom are deemed to be employees of the Trust. No options have been issued since 2002.

The Trust has elected to prospectively adopt amendments to the recommendations of the CICA on accounting for stock based compensation in accordance with the transitional provisions contained therein. Under the amended recommendations, the Trust must account for compensation expense based on the fair value of the options at the grant date. As the Trust has not granted any options since December 31, 2002, this change in accounting policy has no impact on the consolidated financial statements. For options granted in 2002 the Trust elected to continue accounting for compensation expense based on the intrinsic value of the options at the grant date and disclose pro forma net income and pro forma net income per Trust unit as if the fair value method had been adopted retroactively. The exercise price of options granted under the Unit Incentive Plan may be reduced in future periods in accordance with the terms of the Unit Incentive Plan. The amount of the reduction cannot be reasonably determined as it is dependent upon a number of factors including, but not limited to, future prices received on the sale of oil and natural gas, future production of oil and gas, and the determination of the amount to be withheld from future distributions to fund capital expenditures. Therefore, it is not possible to determine a fair value for the options granted under the Unit Incentive Plan and compensation expense has been determined based on the excess of the unit price over the reduced exercise price at the date of the financial statements and recognized in income over the vesting period of the options with a corresponding increase or decrease in contributed surplus. After the options have vested, compensation expense is recognized in income in the period in which a change in the market price of the Trust units or the exercise of the options occurs. The compensation expense under this method in 2003 for the options issued in 2002 is $ 2 million. Net income would have been reduced by this amount and net income per Trust unit would have decreased by $0.03. For 2002, net income would have been reduced by $60,000 with negligible impact on net income per Trust unit.

Consideration paid upon the exercise of the options together with any amount previously recognized in contributed surplus is recorded as an increase in unitholders' capital.

3. ACQUISITIONS

(a) Solaris Oil & Gas Inc.

On February 7, 2003, PC acquired 100% of the outstanding common shares of Solaris Oil & Gas Inc. for $7.4 million in cash and assumed $1.2 million of debt including negative working capital and the outstanding bank loan.

The acquisition was accounted for using the **purchase** method. A summary of the net **assets** acquired is a follows:

	$000's
Working capital	$ (813)
Oil and gas properties	13,219

Bank loan	(370)
Future income taxes	(4,676)
	$ 7,360

(b) NCE Energy Trust

On May 30, 2002, Petrofund Energy Trust acquired NCE Energy Trust for 0.2325 of a Trust unit for each Trust unit on a tax-free rollover basis. The value assigned to the Trust units of $13.024 per unit issued on the acquisition was based on the average market value of the Trust units five days before and after the acquisition was announced.

The acquisition was accounted for using the **purchase** method. A summary of the net **assets** acquired is as follows:

	$000's
Working capital	$ (39,518)
Oil and gas properties	165,254
Future income taxes	(27,097)
	$ 98,639

Prior to the acquisition, Petrofund advanced $37.3 million to NCE Energy Trust to pay down the bank debt of NCE Energy Trust.

(c) Magin Energy Inc. ("Magin")

On June 25, 2001, PC acquired 93.6% of the outstanding common shares of Magin and on July 3, 2001 acquired the remaining shares. Magin was amalgamated into PC on July 3, 2001.

In total, PC acquired 38,338,535 Magin common shares for $58.6 million in cash, 8.5 million trust units with a deemed value of $18.56 per unit and the assumption of $43.7 million of debt including negative working capital, the outstanding bank loan and capital leases. In addition, other transaction costs of $11.8 million were incurred.

The acquisition was accounted for using the **purchase** method. A summary of the net **assets** acquired is as follows:

	$000's
Working capital	$ (4,749)
Oil and gas properties	381,043
Bank loan	(21,569)
Capital leases	(17,359)
Future income taxes	(109,790)
	$ 227,576

4. RELATED PARTY TRANSACTIONS

(a) Management, advisory and administration agreement

PC, NCEP Management, the Previous Manager, and the Trust had entered into an agreement which was amended from time to time, whereby the Previous Manager was to provide management, advisory and administrative services to PC and the Trust. During 2002 the Previous Manager was paid a management fee equal to 3.25% of net operating income plus Alberta Royalty Credit (2001-3.75%). In addition the Previous Manager received an investment fee of 1.5% (1.75% prior to January 1, 2002) of the purchase cost of all properties purchased by PC other than replacement properties, and a disposition fee equal to 1.25% (1.5% prior to January 1, 2002) of the sale price of properties sold. During 2002, the Previous Manager received a management fee from PC of $4.7 million (2001 - $5.3 million). In addition,

the Previous Manager received investment fees of $1.3 million (2001 - $5.2 million), which were capitalized as part of the acquisitions, and disposition fees of $116,000 (2001 - $3,000), which reduced the proceeds of disposition. No management fees have been charged directly to the Trust.

Due to the internalization of management, no fees were payable in 2003. (See Note 9)

Under the terms of the agreement, the Previous Manager was entitled to be reimbursed by PC for general and administrative expenses. In any year, PC was to reimburse the Previous Manager no less than $240,000 and no more than 5% of gross production revenue for general and administrative expenses. To the extent that general and administrative expenses exceed 5% of gross production revenue, PC was entitled to set off and deduct the excess from its liability to pay management fees to the Previous Manager.

(b) Management agreement

The Previous Manager had entered into an agreement with NMSI to provide oil and gas investment, consulting, administrative and management services to PC. An officer and director of the Previous Manager is the sole beneficial shareholder of NMSI. During 2002 PC paid NMSI $11.7 million (2001 - $9.3 million) for accounting and administrative services, which is included in general and administrative expenses and $838,000 (2001 - $1.4 million) for project sourcing and evaluation services, which have been capitalized to oil and gas properties. In addition, PC reimbursed NMSI $300,000 (2001 - $600,000) for marketing and other related equity issue costs. No amounts for these services have been charged directly to the Trust. The amounts for general and administrative expenses paid to NMSI are subject to the same limitations noted for the Previous Manager in (a) above.

5. LONG-TERM DEBT

Under the loan agreements, PC has a revolving working capital operating facility of $25 million and a syndicated facility of $240 million. Interest on the working capital loan is at prime and interest on the syndicated facility varies with PC's debt to cash flow ratio from prime to prime plus 75 basis points or, at the Trust's option, banker's acceptances rates plus stamping fees. As at December 31, 2003, there was no amount outstanding under the working capital facility and $110 million outstanding under the syndicated facility.

The revolving period on the syndicated facility ends on May 28, 2004, unless extended for a further 364 day period. In the event that the revolving bank line is not extended at the end of the 364 day revolving period, no payments are required to be made to non-extending lenders during the first year of the term period. However, Petrofund will be required to maintain certain minimum balances on deposit with the syndicate agent.

The limit of the syndicated facility is subject to adjustment from time to time to reflect changes in PC's asset base.

The credit facility is secured by a debenture in the amount of $350 million pursuant to which a Canadian chartered bank (the "Lender"), as principal and as agent for the other lender, received a first ranking **security interest** on all of PC's assets.

The loan is the legal obligation of PC. While principal and interest payments are allowable deductions in the calculation of royalty income, the Unitholders have no direct liability to the bank or to PC should the assets securing the loan generate insufficient cash flow to repay the obligation.

Substantially all of the credit facility is financed with Bankers' Acceptances, resulting in a reduction in the stated bank loan interest rates.

6. CAPITAL LEASE OBLIGATIONS

The future minimum lease payments under the capital leases are as follows:

	$000's
2004	$ 423

2005	621
Total minimum lease payments	1,044
Less imputed interest at rates ranging from 7.37% to 8.425%	(80)
Obligation under capital leases	964
Current portion	(356)
Long-term portion	$ 608

7. RECLAMATION AND ABANDONMENT RESERVE

PC maintains a cash reserve to finance large and unusual oil and gas property reclamation and abandonment costs by withholding distributions accruing to Unitholders. At December 31, 2003, the cash reserve was $3.8 million (2002 - $3.0 million, 2001 - $2.1 million). In 2003, PC increased the cash reserve by withholding $776,000 (2002 - $706,000, 2001 - $447,000) from distributions accruing to Unitholders.

In addition, routine ongoing reclamation and abandonment costs of $4.7 million in 2003 (2002 - $2.2 million, 2001 - $384,000) were incurred and deducted from distributions accruing to Unitholders.

8. TRUST UNITS

Authorized: unlimited number of trust units	Number of Units	$000's
Issued		
December 31, 2000	21,914,079	$ 321,344
Issued for cash	11,183,334	167,350
Issued for Magin acquisition	8,464,399	157,139
Commissions and issue costs	-	(11,781)
Options exercised	341,305	5,620
Unit purchase plan	13,279	220
December 31, 2001	41,916,396	639,892
Issued for cash	4,600,000	59,800
Issued for NCE Energy acquisition	7,573,874	98,639
Commissions and issue costs	-	(4,190)
Options exercised	7,966	85
Unit purchase plan	10,184	126
December 31, 2002	54,108,420	794,352
Issued for cash	15,800,000	204,440
Issued for internalization of management contact	100,244	1,123
Exchangeable shares converted	1,000,000	11,200
Commissions and issue costs	-	(11,001)
Options exercised	1,673,404	20,474
Unit purchase plan	6,509	89
December 31, 2003	72,688,577	$ 1,020,677

The Trust has a Distribution Reinvestment and Unit Purchase Plan (the "Plan") for Canadian residents. Under the terms of the Plan, Unitholders can elect, firstly, to reinvest their cash distributions and

obtain either newly issued units of the Trust directly from the Trust or previously issued units of the Trust purchased in the open market and, secondly, to purchase for cash newly issued units directly from the Trust.

For the years ended December 31,	2003	2002	2001
Distributions reinvested to acquire previously issued units (000's)	$ 4,095	$ 3,387	$ 6,979
Price per unit	$ 13.20	$ 12.15	$ 16.61
Number of units acquired	310,276	278,797	420,100
Distributions reinvested to acquire newly issued units	$ 89	$ 126	$ 220
Price per unit	$ 13.65	$ 12.36	$ 16.59
Number of units acquired	6,509	10,184	13,279

The weighted average Trust units/exchangeable shares outstanding are as follows:

For the twelve months ended December 31,	2003	2002	2001
Basic	61,010,105	49,921,523	31,593,378
Diluted	61,153,027	49,967,648	31,635,976

Trust units/exchangeable shares:

For the years ended December 31,	2003	2002	2001
Trust units outstanding	72,688,577	54,108,420	41,916,396
Trust units issuable on exchangeable shares (Note 10)	939,147	-	-
	73,627,724	54,108,420	41,916,396

9. INTERNALIZATION OF MANAGEMENT

On April 29, 2003, PC purchased 100% of the outstanding shares of NCEP Management, and NMSI. As a result of these transactions, all management acquisition and disposition fees payable to the Previous Manager were eliminated retroactive to January 1, 2003.

The total consideration paid was $30.9 million as detailed below.

Total Consideration	$000's
Issuance of 1,939,147 exchangeable shares to the shareholder of the Previous Manager	$ 21,718
Cash payment to Trust for the repayment of indebtedness owing by the Previous Manager	3,400
Issuance of 100,244 units to executive management	1,123
Cash payment to executive management	780
Cash payment for distributions on exchangeable shares and trust units from January 1 to April 30, 2003	1,326
Transaction costs	2,503
Total Purchase Price	$ 30,850

To ensure an orderly transition of the services that were provided by the Previous Manager through its offices in Toronto, PC entered into an

agreement with Sentry Select Capital Corp. ("Sentry") to provide certain services to the Trust and PC until December 31, 2003, for a maximum cost of $2 million. The amount incurred decreased from $1 million in the first quarter of 2003 to $500,000 in the second quarter and to $250,000 in each of the third and fourth quarters. As of December 31, 2003, Sentry no longer provides any services to Petrofund or to any of its subsidiaries. Sentry is a company in which John Driscoll, the Chairman of the Board of Directors of PC, owns a controlling interest.

Prior to the acquisition, the Previous Manager was paid a management fee equal to 3.25% of net operating income plus Alberta Royalty Credit, an investment fee equal to 1.50% of the purchase price of all properties purchased by PC and a disposition fee of 1.25% of properties sold, except replacement properties.

10. EXCHANGEABLE SHARES

The number of Exchangeable Shares to be issued in connection with the internalization of the management contract was determined based on a negotiated value of $12.17 per share as set out in the Information Circular dated March 10, 2003. For accounting purposes, the 1,939,147 Exchangeable Shares were deemed to be issued at a value of $11.20 per share, being the average trading value of the Trust units for the last ten days prior to the closing date. Initially, each Exchangeable Share was exchangeable into one Trust Unit. The exchange ratio is adjusted from time to time to reflect the per unit distributions paid to unitholders after the closing date. Under the terms of the Exchangeable Share Agreement, the holder of the Exchangeable Shares is entitled to redeem for cash the number of shares equal to the cash distributions that would have been received had the Exchangeable Shares been converted to Trust units. As a result of the redemption feature, the number of Trust units issuable upon conversion is expected to remain constant over time. As the substance of this feature is to allow the holder of the Exchangeable Shares to receive cash distributions, the redemption has been accounted for as a distribution of earnings rather than a return of capital. In 2003, 181,041 Exchangeable Shares were redeemed for $2.8 million in cash.

On December 17, 2003, 906,635 Exchangeable Shares were converted to 1,000,000 Trust units at a rate of 1.10298. At December 31, 2003, 851,471 Exchangeable Shares were outstanding, at an exchange ratio of 1.10298 per Trust Unit.

Issued and Outstanding	Number of Shares	$000's
Issued for internalization of Management Contract	1,939,147	$ 21,718
Redemption of Shares	(181,041)	-
Exchanged for Trust Units	(906,635)	(11,200)
Balance, December 31, 2003	851,471	10,518
Exchange ratio, end of period	1.10298	-
Trust Units issuable upon conversion	939,147	$ 10,518

11. UNIT INCENTIVE PLAN

A total of 5,200,000 units have been reserved for issuance under the Unit Incentive Plan of which 2,254,100 have been issued as at December 31, 2003.

A summary of the status of the Unit Incentive Plan as of December 31, 2003, 2002 and 2001, and changes during the years then ended is presented below:

For the years ended December 31,	2003	2002	2001

	Units	Weighted Average Exercise Price	Units	Weighted Average Exercise Price	Units	Weighted Average Exercise Price
Options outstanding, beginning of year	3,028,280	$13.21	1,840,190	$15.92	941,278	$16.71
Issued	-	-	1,468,100	10.65	1,477,800	17.65
Forfeited	(555,754)	16.82	(272,044)	16.66	(237,583)	18.38
Exercised	(1,673,404)	12.88	(7,966)	10.65	(341,305)	16.47
Options outstanding before reduction of exercise price	799,122	$14.74	3,028,280	$13.31	1,840,190	$17.29
Reduction of exercise price	-	(1.81)	-	(0.10)	-	(1.37)
Options outstanding, end of year	799,122	$12.93	3,028,280	$13.21	1,840,190	$15.92
Options exercisable, end of year	440,656	$15.36	1,593,681	$14.10	745,565	$16.08

The options granted in 2002 and 2001 are exercisable at the original option prices, which were the market prices of the units on the date of the grants, or if so elected by the participant, at reduced prices as described below. The option prices are reduced for each calendar quarter ending after the date of the grant by the positive amount, if any, equal to the amount by which the aggregate distributions made by the Trust in any calendar quarter ending after the date of the grant exceed 2.5% of the oil and gas royalty and property interests on the Trust's consolidated balance sheet at the beginning of the applicable calendar quarter divided by the issued and outstanding units at the beginning of the applicable quarter.

The following table summarizes the options outstanding at December 31, 2003:

Number of Units	Exercise Price	Reduced Exercise Price	Expiry Date
4,689	$ 15.00	N/A	May 8, 2005
280,666	$ 19.35	$ 16.23	January 30, 2006
109,067	$ 17.25	$ 14.78	April 4, 2006
21,800	$ 14.71	$ 13.31	July 20, 2006
382,900	$ 10.65	$ 9.93	July 25, 2007

12. DISTRIBUTIONS ACCRUING TO UNITHOLDERS

Under the terms of the Trust Indenture, the Trust makes monthly distributions within a specified period following the end of each month ("Cash Distribution Date"). Distributions are equal to amounts received by the Trust on the Cash Distribution Date less permitted expenses. Distributions to Unitholders coincide with cash receipts of royalty income from PC. An overall analysis is as follows:

For the period ended	Cash Distribution Date	2003	2002	2001

November 30	January 31	$ 0.15	$ 0.15	$ 0.42
December 31	February 28	0.16	0.15	0.42
January 31	March 31	0.17	0.13	0.42
February 28	April 30	0.17	0.13	0.42
March 31	May 31	0.18	0.14	0.45
April 30	June 30	0.18	0.14	0.45
May 31	July 31	0.18	0.14	0.36
June 30	August 31	0.18	0.14	0.32
July 31	September 30	0.18	0.14	0.25
August 31	October 31	0.18	0.15	0.25
September 30	November 30	0.18	0.15	0.25
October 31	December 31	0.18	0.15	0.23
Cash Distributions per Trust unit		$ 2.09	$ 1.71	$ 4.24

Reconciliation of Distributions Accruing to Unitholders
(thousands of dollars except per unit amounts)

For the years ended December 31,	2003	2002	2001
Distributions payable, beginning of year	$ 30,065	$ 12,188	$ 28,425
Distributions accruing during the year			
Cash flow from operating activities	187,585	112,570	110,176
Redemption of exchangeable shares	(2,792)	-	-
Proceeds on disposition of property interests	-	946	3,546
Reclamation and abandonment reserve	(776)	(706)	(447)
Less capital lease repayment (2)(3)	(3,305)	(5,366)	(2,629)
Capital expenditures	(30,000)	(10,000)	-
Total distributions accruing during the year	150,712	97,444	110,646
NCE Energy Trust cash flow (1)	-	5,651	-
Total distributable income for the year	150,712	103,095	110,646
Distributions paid	(127,325)	(85,218)	(126,883)
Distributions payable, end of year(4)	$ 53,452	$ 30,065	$ 12,188
Distributions accruing to Unitholders per Trust unit			
Basic	$ 2.47	$ 2.07	$ 3.50
Diluted	$ 2.46	$ 2.06	$ 3.49

(1) Remaining undistributed cash flow of NCE Energy Trust on May 30, 2002 (see Note 3b).
(2) Net of $6 million refinanced by increased bank loan in 2002.
(3) Net of $6 million refinanced by increased bank loan in 2003.
(4) It is expected that a portion of this amount will be used to fund capital expenditures.

13. FINANCIAL INSTRUMENTS

The Trust's financial instruments consist of cash, accounts receivable and payable, long-**term** debt, capital **lease**

obligations and derivative instruments. As at December 31, 2003, the carrying value of the cash and accounts receivable and payable approximated their fair value due to their short-term nature. The carrying value of the long-term debt approximated its fair value due to **the floating** rate of interest charged under the facilities. The carrying value of the capital lease obligations is not significantly different from their fair values.

The derivative instruments have no carrying value (**see** Note 14). The derivative instruments at December 31, 2003, had a negative fair value of $6.8 million based on quotes provided by brokers. This fair value represents an approximation of amounts that would be paid to counterparties to settle these instruments at the balance sheet date. The Trust plans to hold all derivative instruments outstanding at December 31, 2003, to maturity.

14. DERIVATIVE FINANCIAL INSTRUMENTS AND PHYSICAL CONTRACTS

The Trust enters into various pricing mechanisms to reduce price volatility and establish minimum prices for a portion of its oil and gas production. These include fixed-price contracts and the use of derivative financial instruments.

The outstanding derivative financial instruments, all of which constitute effective hedges, and the related unrealized gains or losses, and physical contracts as at December 31, 2003, are summarized separately below:

Natural Gas	Term	Volume mcf/d	Price $/mcf	Delivery Point	Unrealized Gain (Loss) $000's
Collar	November 1, 2003 to March 31, 2004	9,475	$ 6.23- $ 8.34	AECO	$ 118
Collar	November 1, 2003 to March 31, 2004	9,475	$ 5.80- $10.98	AECO	164
Fixed	January 1, 2004 to March 31, 2004	4,737	$ 6.07	AECO	(316)
Fixed	January 1, 2004 to March 31, 2004	4,737	$ 6.23	AECO	(246)
Fixed	January 1, 2004 to March 31, 2004	4,737	$ 6.81	AECO	18
Fixed	January 1, 2004 to March 31, 2004	4,737	$ 7.39	AECO	255
Collar	April 1, 2004 to October 31, 2004	9,475	$ 5.17- $ 7.28	AECO	268
Collar	April 1, 2004 to October 31, 2004	9,475	$ 5.07- $ 6.81	AECO	(66)
Collar	April 1, 2004 to October 31, 2004	1,895	$ 5.28- $ 7.39	AECO	56
Fixed	April 1, 2004 to October 31, 2004	4,737	$ 5.33	AECO	(550)
Collar	November 1, 2004 to March 31, 2005	9,475	(1)	AECO	54
Total					$ (245)

(1) At Prices above $8.97/mcf Petrofund receives $8.97/mcf.
At Prices between $5.80/mcf and $8.97/mcf receives the market price.
At Prices below $4.74/mcf Petrofund receives a premium of $1.06/mcf.

Oil	Term	Volume bbl/d	Price $/bbl	Delivery Point	Unrealized Gain (Loss) $000's
Fixed Price	January 1, 2004 to June 30, 2004	1,995	$38.59	Edmonton	$ (897)
Fixed Price	July 1, 2004 to December 31, 2004	668	$36.41	Edmonton	(186)
Collar	January 1, 2004 to March 31, 2004	2,000	$31.12- $35.98	Edmonton	(999)
Three Way Collar	January 1, 2004 to June 30, 2004	2,000	(1)	Edmonton	(1,478)
Collar	April 1, 2004 to June 30, 2004	2,000	$31.12- $36.56	Edmonton	(768)
Three Way Collar	July 1, 2004 to December 31, 2004	2,000	(2)	Edmonton	(892)
Collar	July 1, 2004 to September 30, 2004	2,000	$31.12- $36.30	Edmonton	(591)
Collar	October 1, 2004 to December 31, 2004	2,000	$31.12- $36.30	Edmonton	(505)
Three Way Collar	January 1, 2005 to December 31, 2005	1,000	(3)	Edmonton	(516)
Total					$ (6,832)

(1) At Prices above $37.27 Petrofund receives $37.27/bbl.
At Prices between $31.12 and $37.27/bbl Petrofund receives the market price.
At Prices below $27.55 Petrofund receives a premium of $3.89/bbl.
(2) At Prices above $37.60 Petrofund receives $37.60/bbl.
At Prices between $31.45 and $37.60/bbl Petrofund receives the market price.
At Prices below $27.87 Petrofund receives a premium of $3.89/bbl.
(3) At Prices above $37.60 Petrofund receives $37.60/bbl.
At Prices between $31.12 and $37.60/bbl Petrofund receives the market price.
At Prices below $25.93 Petrofund receives a premium of $5.19/bbl.

All the oil hedges are at U.S. WTI prices and have been converted to Canadian dollars at the year end exchange rate of $1.2965 C$:US$.

Electricity	Term	Volume MW/h	Price $/MWh	Delivery Point	Unrealized Gain (Loss) $000's

Fixed Price	January 1, 2004 to December 31, 2005	3.0	$ 44.50	Alberta Power Pool	$ 303

The gains or losses are recognized on a monthly basis over the terms of the contracts and adjust the prices received.

Derivative financial instruments and physical hedge contracts involve a degree of credit risk, which the Trust controls through the use of financially sound counterparties. Market risk relating to changes in value or settlement cost of the Trust's derivative financial instruments is essentially offset by gains or losses on the underlying physical sales.

15.

INCOME TAXES

(thousands of dollars except per unit amounts)

The future income tax liability (asset) includes the following temporary differences:

As at December 31,	2003	2002	2001
Oil and gas properties	$ 77,005	$ 119,825	$ 106,961
Resource allowance	-	(2,980)	(2,961)
	$ 77,005	$ 116,845	$ 104,000

The provision for current and future income taxes differs from the result which would be obtained by applying the combined federal and provincial statutory tax rates to income before income taxes. This difference results from the following:

As at December 31,	2003	2002	2001
Income before income tax provision	$ 41,857	$ 10,165	$ 40,128
Income tax provision computed at statutory rates	$ 17,052	$ 4,294	$ 17,304
Effect on income tax of:			
Income attributed to the Trust	(41,468)	(24,435)	(32,665)
Internalization of management contract	12,568	-	-
Non-deductible crown charges, net of Alberta Royalty Credit	24,190	17,055	19,276
Resource allowance	(20,730)	(15,045)	(16,661)
Capital taxes	1,000	831	1,130
Income tax rate reductions on opening balances	(36,688)	-	(329)
Temporary differences in resource allowance	-	(19)	(2,427)
Other	129	3,105	512
Provision for (recovery of) income taxes	$ (43,947)	$ (14,214)	$ (13,860)

The petroleum and natural gas properties and facilities owned by the Subsidiaries have a tax basis of $232.7 million ($212 million - 2002, $153.3 million - 2001) available for future use as deductions from taxable income. Included in this tax basis are non-capital loss carry forwards of $43.6 million ($34.0 million - 2002, $33.6 million - 2001), which could expire in various years through 2010.

16. NET INCOME PER TRUST UNIT

Basic per unit calculations are based on the weighted average number of Trust units and exchangeable shares outstanding. Diluted calculations include additional Trust units for the dilutive impact of options. There were no adjustments to net income in calculating diluted per Trust unit amounts.

The weighted average units/exchangeable shares outstanding are as follows:

For the twelve months ended December 31,	2003	2002	2001
Basic	61,010,105	49,921,523	31,593,378
Diluted	61,153,027	49,967,648	31,635,976

NON RESIDENT OWNERSHIP

As at January 30, 2004, based on information provided by our transfer agent, Petrofund estimates that non-resident ownership of the trust was approximately 64%.

RESERVES SUMMARY

Petrofund has received the results of an independent engineering evaluation of its oil and gas reserves conducted by Gilbert Laustsen Jung Associates Ltd. ("GLJ") effective December 31, 2003. This evaluation is prepared in accordance with National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities (NI 51-101). This new instrument adopted by the Canadian Securities Administrators sets out standards of disclosure for oil and gas activities and mandates the application of evaluation standards defined in the Society of Petroleum Evaluation Engineers (SPEE) Canadian Oil and Gas Evaluation Handbook (COGEH). The information that follows has been derived from the GLJ evaluation.

In prior years the reserve category most often referenced was "Proved plus Risked Probable", also known as "Established". The new standard does not include this definition, however, the evaluation criteria in NI 51-101 make the new "Proved plus Probable" category reasonably comparable to the old Established category. Year over year comparisons will therefore be done using Established reserves from December 31, 2002 and Proved plus Probable reserves from December 31, 2003.

HIGHLIGHTS

These highlights are based on the forecast prices and costs evaluation.

-- Proved plus Probable reserves are 102.7 million boe, an increase of 3% over last year.

-- Acquisition and development activity added 20.3 million boe of company interest Proved plus Probable reserves replacing actual 2003 production 2 times.

-- Disposition of non-core properties totaled 5 million boe of Company interest Proved plus Probable reserves.

-- Technical revisions including adjustments for infill drilling reduced proved plus probable reserves by 1.3 million boe's, or approximately 1%.

-- Reserve life index is 11.1 years.

RESERVE SUMMARY 2003

Summary of Oil and Gas Reserves as of December 31, 2003
Based on Forecast Price and Costs

	Light and Medium Oil		Heavy Oil		Natural Gas	
	Gross	Net	Gross	Net	Gross	Net
	(mbbls)		(mbbls)		(mmcf)	
PROVED						

Developed						
Producing	32,512	28,565	848	750	191,682	151,527
Developed						
Non-producing	276	260	0	0	6,071	4,616
Undeveloped	8,675	8,196	0	0	5,408	4,177
TOTAL PROVED	41,463	37,021	848	750	203,161	160,320
PROBABLE	10,889	9,458	203	182	45,605	36,114
TOTAL PROVED PLUS PROBABLE	52,352	46,479	1,051	932	248,766	196,434

	Natural Gas Liquids		Total BOE's	
	Gross	Net	Gross	Net
	(mbbls)		(mboes)	
PROVED				
Developed				
Producing	5,060	3,577	70,367	58,146
Developed				
Non-producing	154	112	1,442	1,142
Undeveloped	377	258	9,953	9,150
TOTAL PROVED	5,591	3,947	81,762	68,438
PROBABLE	1,575	1,208	20,268	16,867
TOTAL PROVED PLUS PROBABLE	7,166	5,155	102,030	85,305

NET PRESENT VALUE SUMMARY 2003

Petrofund's reserves were evaluated using GLJ's price forecast effective January 1, 2004. The net present values shown below do not necessarily represent the fair market value of the reserves.

Net Present Value of Future Net Revenue Before Income Taxes
At of December 31, 2003
Based on Forecast Price and Costs

	Undiscounted	Discounted at the Rate of 10%	12%	15%
	($millions)	($millions)		
PROVED				
Developed				
Producing	$ 790.0	$ 513.3	$ 483.3	$ 445.6
Developed				
Non-Producing	24.5	14.8	13.7	12.3
Undeveloped	110.9	36.6	29.6	21.4
TOTAL PROVED	925.3	564.7	526.5	479.3
PROBABLE	319.5	114.1	98.5	80.7
TOTAL PROVED PLUS PROBABLE	$1,244.8	$ 678.8	$625.0	$ 560.0

GLJ January 1, 2004 Price Forecast

Summary of Pricing Assumptions as of December 31, 2003
Forecast Prices

Year	Oil WTI (US$/bbl)	Oil Edmonton Par (C$/bbl)	Natural Gas AECO Spot (C$/mmbtu)	Exchange Rate ($US/$Cdn)	Inflation (%)
2004	$ 29.00	$ 37.75	$ 5.85	0.75	1.5
2005	26.00	33.75	5.15	0.75	1.5
2006	25.00	32.50	5.00	0.75	1.5
2007	25.00	32.50	5.00	0.75	1.5
2008	25.00	32.50	5.00	0.75	1.5
2009	25.00	32.50	5.00	0.75	1.5
2010	25.00	32.50	5.00	0.75	1.5
2011	25.00	32.50	5.00	0.75	1.5
2012	25.00	32.50	5.00	0.75	1.5
2013	25.00	32.50	5.00	0.75	1.5
2014	25.00	32.50	5.00	0.75	1.5

Note: Prices escalate 1.5% in 2015 and thereafter.

RESERVE RECONCILIATION

Reconciliation of Company Net Reserves
Constant Prices and Costs

	Light and Medium Oil	Heavy Oil	Natural Gas	Natural Gas Liquids	Barrels of Oil Equivalent
	Net Proved				
	(mbbls)	(mbbls)	(bcf)	(mbbls)	(mboe)
December 31, 2002	34,834	553	181	4,175	69,753
Extensions	159	-	1	30	332
Improved Recovery	681	-	-	11	757
Technical Revisions	(1,303)	318	(8)	(1,007)	(3,391)
Discoveries	79	-	-	-	79
Acquisitions	9,319	-	15	1,367	13,201
Dispositions	(2,186)	-	(2)	(13)	(2,537)
Economic Factors	(102)	-	1	17	11
Production	(3,689)	(121)	(23)	(545)	(8,248)
December 31, 2003	37,793	750	164	4,036	69,957

	Light and Medium Oil	Heavy Oil	Natural Gas	Natural Gas Liquids	Barrels of Oil Equivalent

	Net Proved plus Probable				
	(mbbls)	(mbbls)	(bcf)	(mbbls)	(mboe)
December 31, 2002	41,592	593	213	4,937	82,602
Extensions	182	-	1	34	385
Improved Recovery	189	-	-	13	280
Technical Revisions	1,175	461	(6)	(713)	(27)
Discoveries	100	-	-	-	100
Acquisitions	11,667	-	17	1,496	16,020
Dispositions	(3,705)	-	(3)	(22)	(4,287)
Economic Factors	(39)	-	1	45	222
Production	(3,689)	(121)	(23)	(545)	(8,248)
December 31, 2003	47,471	933	200	5,247	87,048

Reconciliation of Total Company Interest Reserves
Forecast Prices and Escalated Costs

	Light and Medium Oil	Heavy Oil	Natural Gas	Natural Gas Liquids	Barrels of Oil Equivalent
	Proved				
	(mbbls)	(mbbls)	(bcf)	(mbbls)	(mboe)
December 31, 2002	38,014	826	233	5,925	83,633
Extensions	181	-	1	43	407
Improved Recovery	775	-	1	16	875
Technical Revisions	(1,062)	180	(15)	(1,567)	(4,918)
Discoveries	90	-	-	1	91
Acquisitions	10,636	-	19	2,002	15,771
Dispositions	(2,488)	-	(3)	(19)	(2,940)
Economic Factors	(168)	-	-	(6)	(240)
Production	(4,402)	(144)	(30)	(759)	(10,371)
December 31, 2003	41,577	861	205	5,637	82,309

	Light and Medium Oil	Heavy Oil	Natural Gas	Natural Gas Liquids	Barrels of Oil Equivalent
	Proved plus Probable				
	(mbbls)	(mbbls)	(bcf)	(mbbls)	(mboe)

December 31, 2002	45,689	1,012	274	6,998	99,399
Extensions	208	-	1	48	473
Improved Recovery	216	-	1	18	334
Technical Revisions	1,480	200	(11)	(1,208)	(1,325)
Discoveries	114	-	-	1	115
Acquisitions	13,614	-	22	2,166	19,363
Dispositions	(4,236)	-	(4)	(30)	(4,983)
Economic Factors	(195)	-	(1)	(11)	(306)
Production	(4,402)	(144)	(30)	(759)	(10,371)
December 31, 2003	52,487	1,068	252	7,223	102,698

Note: Company working interest reserves includes royalty interest and Working interest.

Additional details regarding Petrofund's reserves information will be included in our Annual Information Form, which is anticipated to available on our website and SEDAR by the end of March.

Petrofund Energy Trust is a Calgary based royalty trust that acquires and manages producing oil and gas properties in Western Canada. The Trust makes monthly cash distributions to unitholders, which are derived from the Trust's cash flow from these properties. Petrofund Energy Trust was founded in 1988 and was one of the first oil and gas royalty trusts in Canada.

This news release may include statements about expected future events and/or financial results that are forward-looking in nature and subject to risks and uncertainties. For those statements, we claim the protection of the safe harbor for forward-looking statements provisions contained in the U.S. Private Securities Litigation Reform Act of 1995. Petrofund Energy Trust cautions that actual performance will be affected by a number of factors, many of which are beyond its control. Future events and results may vary substantially from what Petrofund Energy Trust currently foresees. Discussion of the various factors that may affect future results is contained in Petrofund Energy Trust's recent filings with the Securities and Exchange Commission and Canadian securities regulatory authorities.

PETROFUND ENERGY TRUST
Jeffery E. Errico
President and Chief Executive Officer

Publisher Name: Business Wire
Company Names: *Nce Petrofund Corp.
Industry Names: BUS (Business, General); BUSN (Any type of business)

109/9/6 (Item 6 from file: 621)
03611062 **Supplier Number:** 112179467

Fitch Rates Tricadia CDO 2003-1, Ltd.

Business Wire , p 5792

Jan 14 , 2004
Language: English **Record Type:** Fulltext
Document Type: Newswire ; Trade
Word Count: 315
Text:
Business Editors

NEW YORK--(BUSINESS WIRE)--Jan. 14, 2004

Fitch Ratings assigns the following ratings to Tricadia CDO 2003-1, Ltd.:

-- $76,500,000 class A-1LA **floating-rate notes** due February 2016 'AAA';

-- $8,500,000 class A-1LB **floating-rate notes** due February 2016 'AAA';

-- $85,000,000 class A-2L **floating-rate notes** due February 2016 'AAA';

-- $35,000,000 class A-3L **floating-rate notes** due February 2016 'AA';

-- $12,000,000 class A-4L **floating-rate notes** due February 2016 'A'.

The ratings are based upon the credit quality of the underlying assets and the credit enhancement provided to the capital structure through subordination and excess spread.

The rating of the class A-1LA A-1LB A-2L and A-3L notes addresses the likelihood that investors will receive full and timely payments of interest, as per the governing documents, as well as the stated balance of principal by the legal final maturity date. The rating of the class A-4L notes addresses the likelihood that investors will receive ultimate and compensating interest payments, as per the governing documents, as well as the stated balance of principal by the legal final maturity date.

The notes are supported by the cash flows of an asset portfolio consisting primarily of collateralized loan obligations with exposure to other cash flow collateralized **debt obligation** (CDO) sectors. The portfolio will maintain a weighted average rating factor (WARF) of approximately 'BBB/BBB-'. At closing approximately 80% of the **assets** were **purchased**.

As part of the rating process for this transaction, Fitch stressed the underlying **asset** portfolio with a variety of **default** and **interest** rate scenarios, designed to simulate varying economic conditions. For further details on the stress tests Fitch employed while rating Tricadia CDO 2003-1 Ltd., please refer to the presale report dated Dec. 8, 2003 on the Fitch Ratings web site at 'www.fitchratings.com'.

Publisher Name: Business Wire
Industry Names: BUS (Business, General); BUSN (Any type of business)

109/9/7 (Item 7 from file: 621)
03517357 **Supplier Number:** 107279529
Coronado CDO Rated 'AAA/AA/BBB' by Fitch Ratings.

Business Wire , p 5214
Sept 5 , 2003
Language: English **Record Type:** Fulltext
Document Type: Newswire ; Trade
Word Count: 338
Text:
Business Editors

NEW YORK--(BUSINESS WIRE)--Sept. 5, 2003

Coronado CDO, Ltd.'s and its co-issuer Coronado CDO Corp. (collectively referred to as the co-issuers) is **rated** by Fitch Ratings as follows:

-- $377 million class A-1 floating **rate notes** 'AAA';

-- $5 million class A-2 fixed **rate notes** 'AAA';

-- $62 million class B-1 **floating rate notes** 'AA';

-- $15 million class B-2 **floating rate notes** 'AA';

-- $3.5 million class C-1 **floating rate notes** 'BBB';

-- $16.75 million class C-2 fixed **rate notes** 'BBB'.

The ratings on the class A and B **notes** address the timely payment of interest and principal. The ratings on the class C address the ultimate payment of interest and principal. The notes have a legal final maturity of September 2038.

The ratings are based upon the capital structure of the transaction, the quality of the collateral, and the overcollateralization (OC) and **interest** coverage tests provided for within the **security** agreement. Additionally, the ratings address the experience and capabilities of Western Asset Management Company (Western **Asset**) as the collateral manager.

The proceeds of the notes will be used to **purchase** an investment portfolio consisting primarily of residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), asset-backed securities (ABS), corporate debt securities, and collateralized **debt obligations** (CDOs). Upon the breach of a coverage test as outlined in the security agreement, the notes will start the process of paying down principal sequentially, beginning with class A principal.

The collateral manager, Western **Asset**, will **purchase** all investments for the portfolio on behalf of the co-issuers, which are special purpose companies incorporated under the laws of the Cayman Islands and Delaware, respectively. As of June 2003, Western Asset had under $126 billion of assets under its management, $47 billion of which is structured products.

For more information, please refer to the deal report titled 'Coronado CDO', available on the Fitch Ratings web site at 'www.fitchratings.com'.

Publisher Name: Business Wire
Industry Names: BUS (Business, General); BUSN (Any type of business)

109/9/8 (Item 8 from file: 621)
03476939 **Supplier Number:** 104613291
Fitch Ratings Downgrades Eastman Hill Funding I, Ltd.

Business Wire , p 5485
July 2 , 2003
Language: English **Record Type:** Fulltext
Document Type: Newswire ; Trade
Word Count: 469
Text:
Business Editors

NEW YORK--(BUSINESS WIRE)--July 2, 2003

Fitch Ratings downgrades six classes of **notes** and the subordinate preference shares issued by Eastman Hill Funding I, Ltd., (Eastman Hill). The following rating actions are effective immediately:

-- $488,015,097 class A-1 **floating-rate notes** to 'AA' from 'AAA';

-- $9,531,545 class A-1 fixed-**rate notes** to 'AA' from 'AAA';

-- $497,546,642 class A-2 interest only fixed-**rate notes** to 'AA' from 'AAA';

-- $10,000,000 class A-3 **floating-rate notes** to 'BBB' from 'AA';

-- $25,743,389 class B-1 fixed-**rate notes** to 'B' from 'BBB';

-- $25,000,000 combination securities to 'CC' from 'BBB';

-- $17,875,000 subordinated preference shares to 'C' from 'B+'.

Eastman Hill is a collateralized **debt obligation** (CDO) supported by a pool of high yield corporate bonds (11.1%), investment grade corporate bonds (42.3%), loans (14.3%), and residential mortgage-backed securities (RMBS) (32.3%). The CDO is managed by Trust Company of the West (TCW). As part of the annual rating review process, Fitch has reviewed in detail the portfolio performance of Eastman Hill. Included in this review, Fitch discussed the current state of the portfolio with the asset manager and their portfolio management strategy going forward. In addition, Fitch conducted cash flow modeling utilizing various **default** timing and **interest** rate scenarios.
As a result of this analysis, Fitch has determined that the original ratings assigned to the referenced notes no longer reflect the current risk to noteholders.

Eastman Hill has been failing its class A-1 and B-1 overcollateralization tests since November 2002, as measured by the monthly trustee reports. As of the report dated June 25, 2003, Eastman Hill's defaulted assets represented 3.5% of the $570 million par portfolio amount and eligible investments. Assets rated 'CCC+' and below represented approximately 3.6%, of the portfolio collateral, excluding defaults. The deterioration of the portfolio's credit quality has resulted in a current weighted average rating factor (WARF) of 22 versus a test level of 20.

Additionally, the interest rate swap agreement that is in place to hedge the mismatch between the predominantly fixed-rate collateral and floating-rate liabilities has impacted the performance of Eastman Hill. The current low interest rate environment causes a gap between the strike rate of the interest rate swap agreement and current LIBOR rates.

After discussing Eastman Hill with TCW, Fitch believes that the collateral manager is making efforts to improve the credit quality of the portfolio with **purchases** of higher quality **assets**.
TCW is actively monitoring the portfolio on a daily basis. Fitch will continue to monitor Eastman Hill closely to ensure accurate ratings.

Additional deal information and historical data are available on the Fitch Ratings web site at 'www.fitchratings.com'.

Publisher Name: Business Wire
Industry Names: BUS (Business, General); BUSN (Any type of business)

109/9/9 (Item 9 from file: 20)
26696043
Fitch Rates Zais Investment Grade Limited V

BUSINESS WIRE
December 19, 2002
Journal Code: WBWE **Language:** English **Record Type:** FULLTEXT
Word Count: 428

NEW YORK--(BUSINESS WIRE)--Dec. 19, 2002--Fitch Ratings assigns the following ratings to Zais Investment Grade Limited V:

--US$285,000,000 class A-1 senior secured **floating-rate notes**, 'AAA';

--US$25,000,000 class A-2 senior secured fixed-**rate notes**, 'AA';

--US$37,000,000 class B-1 senior secured **floating-rate**, 'A-';

--US$14,000,000 class B-2 senior secured fixed-**rate notes**, 'A-';

--US$40,000,000 subordinated **notes**, 'BBB-';

--US$7,000,000 type I composition obligations, 'BBB'; and

--US$4,000,000 type II composition obligations, 'BBB'.

The ratings of the class A notes address the likelihood that investors will receive full and timely payments of interest on scheduled interest payment dates, as well as the stated balance of original principal by the final payment date. The ratings of the class B notes address the ultimate payment of interest and principal by the final payment date, as well as any compensating interest on deferred interest amounts. The ratings of the subordinated notes address the likelihood that investors will receive the stated balance of the original principal by the final payment date.

The ratings are based upon the credit quality of the underlying assets, the credit enhancement provided to the capital structure through

subordination and excess spread, and the strength of Zais Group LLC as the investment manager.

The proceeds from the notes will be used to purchase a portfolio of predominantly all collateralized **debt obligation** securities (CDOs). At closing, approximately 60% of the total portfolio had been **purchased**. The ratings of the underlying **assets** were used to help assess the credit quality of the collateral. As per the indenture, the investment manager must maintain a weighted average Fitch Factor of 23 which falls between a 'BBB-' and 'BB+' rating. Fitch focuses on a thorough evaluation of the investment manager, the credit quality of the underlying assets, certain structural provisions and maintenance tests established by the governing documents, and modeling exercises that stress the portfolio with a variety of **default** and **interest** rate scenarios designed to simulate varying economic conditions.

In addition to the rating of the notes referenced above, Fitch assigns a 'BBB' rating to the composition notes. The rating of the $7,000,000 type I composition notes address the likelihood that investors will receive the stated balance of principal by the final payment date. The rating of the $4,000,000 type II composition notes address the ultimate payment of interest and principal by the final payment date, as well as any compensating interest on deferred interest amounts. The ratings are based upon the credit quality of the underlying assets that comprise the composition obligations.

--30--EM/sf* CONTACT: Fitch Ratings, New York Charles R. Kassouf, 212/908-0271 Elizabeth Russotto, 212/908-0585 Matt Burkhard, 212/908-0540 (Media Relations)

Company Names: Fitch IBCA
Descriptors: Bonds; Company News; Credit Rating; Market News; Markets
Country Names/Codes: United States of America (US)
Regions: Americas; North America

109/9/10 (Item 10 from file: 20)
21414085
IBRA's asset securitization difficult: Experts

JAKARTA POST , p 11
February 25, 2002
Journal Code: FJKP **Language:** English **Record Type:** FULLTEXT
Word Count: 672

Issuing commercial papers using assets of the Indonesian Bank Restructuring Agency (IBRA) may sound promising, but doubts over asset quality and market demand undermine the effectiveness of the securitization plan, according to analysts.

"If IBRA can pull this off, it (securitization) will unlock its assets," fixed income expert Khalil Rowter said over the weekend.

IBRA took over some Rp 430 trillion (about US$43 billion) worth of loans

from local banks in return for the government recapitalizing them with bonds. The loan assets are now being sold to help the cash-strapped government plug a chronic state budget deficit.

But IBRA asset sales have been progressing slowly, bogged down in part by a sluggish economy that has dampened investors' interest and impeded efforts to restructure the loans.

Although not much is known about the securitization plan, a government official said it would speed up asset sales.

IBRA, through a third institution, can raise cash by issuing commercial papers, and pay for them with **interest** rate payments from the loans it owns. In case of a **default**, investors can seize debtors assets that came attached as collateral for the loans.

Khalil called this collateralized **debt obligation** (CDO), which he said was quite common in housing loans in the U.S.

This scheme was promising for a number of reasons, he said.

Packaging the loans into commercial papers allows investors to trade on them, and thus stay more liquid.

"Commercial papers are tradable, they could be **floating rate notes**, promissory **notes** or bonds," Khalil explained.

Holding commercial papers was also more convenient. He said investors would not need to deal directly with the debtors. They could skip the due diligence as that task would fall on IBRA.

In line with the different risks that loans had, Khalil estimated the commercial papers would come in two categories.

He described the two as junior and senior categories, with the former carrying a greater discount rate but at a higher default risk.

And Khalil said discounts would remain part of any securitization deal of IBRA assets.

Discounts have posed a major cut in IBRA's rate of return, amounting to over 70 percent for unrestructured loans.

Analysts blame this on the massive non-performing loans that have remain stuck in IBRA since they were taken over from local banks during the financial crisis in the late 90s.

Interest payments from these loans have stopped, which makes it tough for IBRA to get a good price on them.

Khalil said IBRA would need to continue to offer a juicy discount rate up-front, as room for raising interest rates was limited.

IBRA could not afford to offer rates beyond debtors' payment capabilities, although the rates should be attractive, he added.

Good IBRA assets were few, and so were the number of investors who would want to buy the securitized ones, he said.

Securitizing the assets, he said, would shut out banks which have been the traditional buyers of IBRA's **assets** loans.

"We're talking here about investors **purchasing** commercial papers, and there are only a few big ones," he explained.

The debt market is crowded with corporate bonds competing against government bonds, although trading in the latter was thin.

Banking analyst Ryan Kiryanto of Bank Negara Indonesia (BNI) said the government might prefer issuing notes over bonds.

"People are allergic to new bonds, this has the potential of inviting resistance from legislators," he said.

Although securitization would not add burden to the state budget, the public opinion of bonds has turned sour.

This year, the government must spend some Rp 58 trillion to serve interest rates on bonds that were issued to recapitalized ailing banks during the financial crisis.

That amount tops development spending, which has been set for Rp 52 trillion this year.

The securitization plan has yet to be approved by the Financial Sector Policy Committee (FSPC), which handles IBRA's debt restructuring deals

worth over Rp 1 trillion.
FSPC secretary Syafruddin Temenggung said the plan was not open for public discussion until the FSPC approved it.
Berni K. Moestafa, The Jakarta Post, Jakarta

Company Names: Indonesian Bank Restructuring Agency
Descriptors: Restructuring; Strategy; Company News; Bonds; Markets; Market News; Corporate Finance
Country Names/Codes: Indonesia (ID)
Regions: Asia; Pacific Rim; South East Asia
SIC Codes/Descriptions: 6020 (Commercial Banks)
Naics Codes/Descriptions: 52211 (Commercial Banking)

109/9/11 (Item 11 from file: 20)
12942568
Canary Wharf Group - Preliminary Results-Part 3

REGULATORY NEWS SERVICE
September 20, 2000
Journal Code: WRNS **Language:** English **Record Type:** FULLTEXT
Word Count: 3950

Part 3
13 FINANCIAL ASSETS

The group's financial assets comprise short term trade debtors (Note 12) and sterling cash deposits. Sterling cash deposits totalled #1,020.6 million at 30 June 2000 (30 June 1999 - #1,016.9 million), comprising deposits placed on money market at call and term rates. Total cash deposits include #574.8 million (30 June 1999 - #405.9 million) held by third parties as cash collateral for the group's borrowings, deposits arising from prepayments in respect of buildings contracted to be sold of #207.0 million (30 June 1999 - #320.2 million) and a further #2.3 million (30 June 1999 - #18.0 million) charged to third parties as **security** for the group's obligations.
The weighted average rate of **interest** on fixed rate deposits at 30 June 2000 was 6.7% (30 June 1999 - 6.5%).
14 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR
30 June 30 June 2000 1999 ------- ------- #m #m Bank loans (Note 15) 17.9 107.2 Trade creditors 31.4 26.0 Taxation and Social Security costs 0.9 0.7 Other creditors 0.6 0.9 Accruals 113.6 120.5 Deferred income 20.6 133.9 ------- ------- 185.0 389.2 ======= =======
At 30 June 2000 deferred income included #Nil (30 June 1999 - #127.0 million) in connection with agreements for the sale, upon completion, of buildings under construction at Canary Wharf. The income deferred was recognised upon completion of construction of the relevant buildings during the year.
At 30 June 2000 accruals included #50.2 million (30 June 1999 - #50.2 million) in respect of the group's remaining contribution to the Jubilee Line Extension, payable on 1 November 2000.
In accordance with the arrangements agreed for the acquisition of the

CWHL group in December 1995, elements of the CWHL group's then existing indebtedness were prepaid early. Further amounts were payable to the vendors (the selling bank group) from funds set aside for this purpose once certain conditions had been satisfied and at 30 June 1999 #17.8 million was accrued in this regard, shown as due within one year. During the year ended 30 June 2000 #15.5 million of the accrual was released in connection with deferred payments which were made to the vendors and the balance of #2.3 million was released to the profit and loss account.

15 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

Creditors due after more than one year comprise:

30 June 30 June 2000 1999 ------- ------- #m #m Securitised debt 923.9 543.7 Term loan - 49.5 Finance lease obligations 675.1 471.8 Deferred income 424.6 405.4 ------- ------- 2,023.6 1,470.4 ======= =======

At 30 June 2000 deferred income of #424.6 million (30 June 1999 - #405.4 million) was held in connection with an agreement for the sale, upon completion, of a building presently under construction at Canary Wharf. The income deferred will be recognised upon completion of construction.

The amounts at which borrowings are stated comprise: Finance Securitised Construction Term lease **debt** Loans Loan **obligations** Total #m #m #m #m #m ---------- ---------- ----- ---------- ------- At 30 June 1999 555.9 94.4 50.1 471.8 1,172.2 Drawn down in year 385.0 24.2 - 197.5 606.7 Deferred financing expenses (4.8) 0.3 - 0.2 (4.3) Accrued finance charges 5.7 2.3 (0.1) 5.6 13.5 Repaid in year - (121.2) (50.0) - (171.2) ---------- ---------- ----- ---------- ------- At 30 June 2000 941.8 - - 675.1 1,616.9 ========== ========== ===== ========== ======= Payable within one year or on demand 17.9 - - - 17.9 Payable in more than one year 923.9 - - 675.1 1,599.0 ---------- ---------- ----- ---------- ------- 941.8 - - 675.1 1,616.9 ========== ========== ===== ========== =======

(1) In June 2000 a group company, CWFII, issued #975 million of first mortgage debentures. The notes comprised: (a) #475 million term notes The term notes consist of five tranches, two of which, totalling #90 million were immediately purchased and are held by a group company. The principal terms of the tranches are: Tranche #m Interest Repayment ------- ------- ------- ------- Issued: A1 240 6.455% By instalment 2009 to 2033 A2 60 Floating By instalment 2003 to 2012 B 85 6.800% By instalment 2005 to 2033 ------- 385 Re-acquired: C 45 6.966% By instalment 2011 to 2033 D 45 Floating By instalment 2011 to 2033 ------- 475 ======= The notes are secured on certain property interests of the CWHL group and the rental income stream therefrom.

The class A2 notes were issued in a principal amount of EUR100m, with interest payable at three month EURIBOR plus a margin of 0.3%. The A2 notes are fully hedged via a currency swap, whereby all principal and interest liabilities are swapped into sterling providing an initial principal of #60 million and interest payable fixed at 6.995%. Interest on the D notes is payable at a rate of three month LIBOR plus a margin of 1.75% until July 2005, and thereafter 4.375%. The D notes are fully hedged using an interest rate collar, with a cap of 9% and a floor of 5%.

The weighted average maturity of the debentures at 30 June 2000 was 18.2 years. The debentures may be redeemed at the option of the issuer in an aggregate amount of not less than #1 million (except class A2 which may not be less than EUR1 million) on any interest payment date, subject to the current ratings of the debentures not being adversely affected and certain other conditions affecting the amount to be redeemed.

Tranches C and D may be resold by the group at any time. (b) #500 million revolving notes The securitisation allows for #500 million of 'AAA' and 'AA' rated fully revolving short term notes, of which #250 million is underwritten for 5 years by a banking syndicate. There were no immediate proceeds from the revolving notes as they were repurchased by the Issuer. Drawings will commence once further fully constructed and leased properties are added to the securitisation pool. The pricing is based on three month LIBOR with a margin of 0.40% for the 'AAA' notes and 0.50% for the 'AA'

notes. The commitment fee is 0.25% of the #250 million underwritten. Hedging is not required until first drawdown.

(2) In December 1997 the company's subsidiary, CWF, issued #555m of first mortgage debentures, the principal terms of which are:

Tranche #m Interest Repayment ------- ----- -------- --------- A 270 7.230% By instalment 2004 to 2027 B 80 7.425% By instalment 2004 to 2027 C 120 Stepped fixed By instalment 2006 to 2027 D 85 Floating By instalment 2007 to 2020 ----- 555 -----

The debentures are secured on certain property interests of the CWHL group and the rental income stream therefrom.

Interest on Tranche C increases in steps from 5% payable until October 1999, to 9.535% payable from October 2006. Interest on Tranche D is payable at LIBOR plus 1.1% until January 2003 and thereafter 3.1%, but the company has entered into an interest rate cap arrangement so as to cap the portion of interest linked to LIBOR at 8.5%.

The weighted average maturity of the debentures at 30 June 2000 was 16.7 years. The debentures may be redeemed at the option of the issuer in an aggregate amount of not less than #1 million on any interest payment date, subject to the current ratings of the debentures not being adversely affected and certain other conditions affecting the amount to be redeemed.

(3) At 30 June 1999, #94.4 million of a construction loan facility of #200 million had been drawn down. This loan was prepaid in November 1999. The construction loan carried interest at a margin of 0.95% over LIBOR and was secured by first ranking fixed and floating charges over the properties which were subject to the financing, by second ranking charges over certain other assets of the CWHL group and by a guarantee from CWHL.

(4) In June 2000 a #50 million five year loan secured by first ranking fixed and floating charges over the retail and parking facilities within the first phase of Canary Wharf was prepaid. The loan carried interest at a margin of 0.85% over LIBOR.

(5)In November 1999 the group granted a long lease in 33 Canada Square. An inferior interest in the property was immediately granted back and the lease back has been accounted for as a finance lease. The obligation to pay future rentals under the finance lease was stated at inception at #197.5 million.

(6) The group's obligations under certain finance leases are secured by first ranking fixed and **floating** charges over the property which is the subject of those finance leases and over certain cash deposits (**Note** 24). The weighted average **rate** of interest implicit in the group's finance leases is 7.4%.

(7) Loans and finance lease obligations falling due after more than one year are repayable as follows:

Finance Finance Loans Leases Loans leases 2000 2000 1999 1999 ----- ------- ------ ------- #m #m #m #m In more than one year but less than two years - - - - In more than two years but not more than five years 60.1 - 49.5 - In more than five years 863.8 675.1 543.7 471.8 ----- ------- ------ ------- 923.9 675.1 593.2 471.8 ===== ======= ====== ======= (8) After taking into account interest rate hedging entered into by the group, the interest rate profile of the group's financial liabilities at 30 June 2000 was:

At 30 June 2000 ------------- ------------ ---------- Floating rate Fixed rate financial financial liabilities liabilities Total ------------- ------------ ---------- #m #m #m Securitised debt 87.0 854.8 941.8 Construction loan - - - Term loan - - - Finance leases 448.4 226.7 675.1 ------------- ------------ ---------- 535.4 1,081.5 1,616.9 Less: Cash collateral for borrowings (**Note** (424.5) (150.3) (574.8) 13) ------------- ------------ ---------- 110.9 931.2 1,042.1 ============= ============ ========== At 30 June 1999 ------------- ------------ ---------- **Floating rate** Fixed **rate** financial financial liabilities liabilities Total #m #m #m Securitised debt 86.0 469.9 555.9 Construction loan 94.4 - 94.4 Term loan 50.1 - 50.1 Finance leases 248.6 223.2 471.8 ------------- ------------ ----------

479.1 693.1 1,172.2 Less: Cash collateral for borrowings (**Note** 13) (269.3) (136.6) (405.9) ------------- ------------ ---------- 209.8 556.5 766.3 ============= ============ ========== The group's **floating rate** liabilities comprise sterling denominated bank borrowings, debentures and finance leases which bear interest at rates linked to LIBOR.

In respect of the group's fixed rate financial liabilities: 30 June 2000 30 June 1999 -------- -------- -------- -------- Weighted Weighted Weighted Weighted average average average average interest period interest period rate fixed rate fixed -------- -------- -------- -------- % Years % Years Securitised debt 7.1 17.9 7.4 17.3 Finance leases 10.0 15.5 10.0 16.3

(9) In accordance with FRS 13 (Derivatives and Other Financial Instruments: Disclosures) the group is required to disclose the fair values of its financial assets and liabilities and at 30 June 2000 these were as follows:

30 June 2000 30 June 1999 ------- ------- ------- ------- Book Fair Book Fair Value Value Value value ------- ------- ------- ------- #m #m #m #m Primary financial instruments held or issued to finance the group's operations: Cash on deposit earning - floating rates of interest 724.0 724.0 629.4 629.4 - fixed rates of 296.6 329.9 387.5 437.1 interest Short term financial liabilities and current portion of long term borrowings (17.9) (17.9) (107.2) (107.4) Long term borrowings (923.9) (962.8) (593.2) (664.1) Finance leases (675.1) (704.1) (471.8) (540.6) Derivative financial instruments held to manage interest rate and exchange rate profile: - interest rate swaps - - - 49.6 - interest rate caps 2.7 1.5 2.6 2.3 - currency swaps - 2.7 - - The fair value of the interest rate swaps and sterling denominated fixed rate debt and deposits have been determined by reference to prices available on the markets on which they are traded. All other fair values shown have been calculated by discounting cash flows at the relevant zero coupon LIBOR interest rates prevailing at the balance sheet date.

During the year #3.8 million was realised on certain interest rate hedges. These hedges were entered into in anticipation of the group's securitisation completed in June 2000 and the gains have therefore been deferred and will be recognised over the term of the debt. Other than the above no gains or losses on derivative financial instruments have been recognised in the year.

16 PROVISION FOR LIABILITIES AND CHARGES #m Provision for amounts payable in relation to partially vacant leasehold properties: As at 1 July 1999 3.3 Release to profit and loss account (0.4) ----- As at 30 June 2000 2.9 =====

At 30 June 2000 the directors reassessed the requirement for a provision in respect of partially vacant leasehold properties and as a result of this assessment the provision was reduced by #0.4 million.

Deferred taxation:

There was no potential or unprovided deferred taxation at 30 June 2000 or 30 June 1999.

If the group's investment properties were sold at their market value, a tax liability of approximately #201.3 million (30 June 1999 - #165.8 million) would arise. As the company has no intention to sell its investment properties and it is not expected that any liability will arise in the foreseeable future, no provision for this contingent liability has been made.

17 SHARE CAPITAL Authorised Issued, allotted and fully paid 2000 1999 2000 1999 ------- ------- ------- ------- #m #m #m #m Ordinary shares of1p each 10.0 10.0 6.9 6.8 ======= ======= ======= =======

Movements in issued share capital: Number Number of ordinary shares in issue at 30 June 1999 684,060,129 Issue on exercise of options (see Note (7)) 1,654,500 ---------- Number of ordinary shares in issue at 30 June 2000 685,714,629 ========== (1) Warrants over 26,867,000 ordinary shares are held by IPC Advisors Limited, a company owned by a trust for the benefit of (inter alios) the Paul Reichmann family. These warrants are

exercisable until 26 December 2005 at a price of 450 pence per share. (2) In December 1997, the Company granted to European Investment Bank warrants to subscribe for shares in the Company in the event of admission to a recognised stock exchange. Pursuant thereto a total of 8,925,233 such warrants were issued and became exercisable on 2 April 1999. In April 2000 these warrants were transferred to IPC Advisors Limited. They remain exercisable until 1 April 2006 at a price of 330 pence per share. The subscription price for, and the number of shares subject to, both issues of warrants are subject to adjustment in certain circumstances, such as capitalisation or rights issues.

(3) On 3 March 1998 options were granted to 17 senior executives including two executive directors under the Canary Wharf Group plc 1997 Executive Share Option Plan to subscribe for 4,977,000 ordinary shares. As a result of a bonus issue of shares on 1 April 1999, and in accordance with the terms of this Plan, the number of ordinary shares under option doubled to 9,954,000 shares and the option price was halved to 79.5 pence per share.

(4) On 31 March 1999 options over 10,354,167 shares, with an option price of 400 pence per share, were granted to fifteen senior executives, including two executive directors. Also on 31 March 1999 an award of 455,579 shares was made to 43 executives under the terms of the Canary Wharf Long Term Incentive Plan. These awards are all subject to performance criteria.

(5) Under the terms of an agreement with a former director of CWHL, options over 184,417 shares were granted to him at a price of 330 pence per share. These options are exercisable until 31 March 2004.

(6) On 12 April 1999 176,129 ordinary shares were issued at a subscription price of 331.5 pence per share to Canary Wharf Trustees Limited as trustee of the Canary Wharf Share Participation Plan on behalf of 409 participants.

(7) During the year ended 30 June 2000 1,654,500 ordinary shares were issued at a subscription price of 79.5 pence per share following the exercise of options under the Canary Wharf Group plc 1997 Executive Share Option Plan. An award of 14,285 shares was also made to an employee under the Canary Wharf Long Term Incentive Plan.

At 30 June 2000 the following warrants to subscribe for, options over and rights to receive ordinary shares, remained outstanding. Exercise Nature Number of price per of ordinary ordinary Person entitled Right shares share (p) Exercise period ---------------- ------- ---------- --------- --------------- IPC Advisors Ltd Warrant 26,867,000 450.0 01/04/99 to 26/12/05 IPC Advisors Ltd Warrant 8,925,233 330.0 02/04/99 to 01/04/06 Share Option Plans: 17 employees 75% current, 25% from including 2 01/01/01, all until directors) Option 8,115,500 79.5 03/03/08 15 employees Phased, commencing on (including 2 31/03/02, all until directors) Option 10,354,167 400.0 03/03/09 Former director of CWHL Option 184,417 330.0 01/04/99 to 31/03/04 Long Term Incentive Plan Shares 455,479 - 31/03/02 to 30/03/09 (44 employees) Shares 14,285 - 21/10/02 to 20/10/09 Share Participation Plan(409 employees) Shares 176,129 -

18 RESERVES Share Group: Premium Revaluation Capital Profit & Account Reserve Reserve Loss Total ------- ------- ------- ------- ------- Equity reserves: #m #m #m #m #m At 1 July 1999 571.3 714.2 61.3 (145.9) 1,200.9 Issue of shares under Executive Share Option Plan 1.3 - - - 1.3 Revaluation of Investment properties - 256.9 - - 256.9 Movement for the financial year - - - 54.1 54.1 ------- ------- ------- ------- ------- At 30 June 2000 572.6 971.1 61.3 (91.8) 1,513.2 ======= ======= ======= ======= =======

19 RECONCILIATION OF MOVEMENTS IN SHAREHOLDERS' FUNDS #m Shareholders' funds as at 1 July 1999 1,207.7 Issue of share capital 1.4 Profit for the financial year 54.1 Revaluation surplus 256.9 ------- Shareholders' funds as at 30 June 2000 1,520.1 =======

20 PENSION SCHEMES

The group operates two defined contribution pension schemes. The

assets of these schemes are held in independently administered funds. The pension cost charge, which amounted to #1,455,744 in the year (year ended 30 June 1999 - #1,035,548) represents contributions payable by the group to the schemes.

21 RECONCILIATION OF OPERATING PROFIT TO OPERATING CASH FLOWS

Year Year ended ended 30 June 30 June 2000 1999 ------- ------- #m #m Operating profit 102.0 25.0 Net profit on disposal of properties (39.1) - Depreciation charges 0.3 0.2 Decrease in debtors 5.4 5.4 Increase in creditors 15.0 12.6 Decrease in provisions (0.4) (0.7) ------- ------- Net cash inflow from operating activities 83.2 42.5 ======= =======

22 ANALYSIS OF CASH FLOWS Year ended Year 30 June ended 2000 30 June 1999 ------- ------- #m #m Returns on investments and Servicing of finance Interest received 38.4 32.4 Interest paid (40.8) (39.1) Interest element of finance lease (44.7) (35.0) rentals Financing expenses (6.0) (1.4) ------- ------- Net cash outflow (53.1) (43.1) ======= =======

Capital expenditure and financial investment Year ended Year 30 June ended 2000 30 June 1999 ------- ------- #m #m Additions to investment properties and properties under development (323.7) (297.6)
Purchase of tangible fixed **assets** (4.6) (0.7)
Purchase of investment properties (373.8) - Settlement of deferred acquisition costs (see note below) (15.5) - Disposal of properties 235.0 - Deferred income relating to agreements for sale of property 19.1 426.2 ------- ------- Net cash (outflow)/inflow (463.5) 127.9 ======= =======

In accordance with the arrangements agreed for the acquisition of the CWHL Group in December 1995, further net deferred payments of #15.5 million were made during the year ended 30 June 2000 to the vendor (the selling bank group) from funds set aside for this purpose at the time of acquisition. Acquisitions Year ended Year 30 June ended 2000 30 June 1999 ------- ------- #m #m Investment in subsidiary undertaking - (7.0) ------- ------- Net cash outflow - (7.0) ======= =======

Management of liquid resources Year ended Year ended 30 June 30 June 2000 1999 ------- ------- #m #m Cash placed on deposit not available on demand (195.8) (327.9) Cash withdrawn from deposit accounts 155.8 89.2 ------- ------- Net cash outflow (40.0) (238.7) ======= =======

Financing Year ended Year ended 30 June 30 June 2000 1999 ------- ------- #m #m Repayment of Senior Secured/Capital Notes - (366.6) Issue of shares 1.4 572.5 Repayment of secured loans (171.2) - Issue of securitised debt 385.0 - Drawdown of secured loan and finance lease premia 221.9 132.4 ------- ------- Net cash inflow 437.1 338.3 ======= =======

23 ANALYSIS AND RECONCILIATION OF NET DEBT

Other non- 1 July Cash cash 30 June 1999 flow changes 2000 ------- ------- ------- ------- #m #m #m #m Cash at bank 1,016.9 3.7 - 1,020.6 Amounts on deposit not available on demand (744.1) (40.0) - (784.1) ------- ------- ------- ------- 272.8 (36.3) - 236.5 ------- ------- ------- ------- Debt due after 1 year (593.2) (330.2) (0.5) (923.9) Debt due within 1 year (107.2) 89.6 (0.3) (17.9) Finance leases (471.8) (159.4) (43.9) (675.1) ------- ------- ------- ------- (1,172.2) (400.0) (44.7) (1,616.9) ------- ------- ------- ------- Amounts on deposit not available on demand 744.1 40.0 - 784.1 ------- ------- ------- ------- Net debt (155.3) (396.3) (44.7) (596.3) ======= ======= ======= =======

Year ended 30 June 2000 ------- #m Increase in cash in the year 3.7 Increase in debt and lease financing (400.0) ------- Change in net debt resulting from cash flows (396.3) Non-cash movement in net debt (44.7) ------- Movement in net debt in year (441.0) Net debt at 1 July 1999 (155.3) ------- Net debt at 30 June 2000 (596.3) =======

24 CONTINGENT LIABILITIES AND FINANCIAL COMMITMENTS

As at 30 June 2000 certain members of the group had given fixed and floating charges over substantially all of their assets as security for certain of the group's borrowings and finance lease obligations as referred to in Note 15. In particular, various members of the group had, at 30 June 2000, given fixed first ranking charges over cash deposits totalling #574.8

million and may be called upon to make a further cash deposit of up to #14.4 million.

As security for the issue of #555 million of securitised debt (see Note 15) the company has granted a first fixed charge over the shares of CWF and a first floating charge has been given over all of the assets of CWF.

As security for the issue of up to #975 million of securitised debt (see Note 15) the company's indirect subsidiary, Canary Wharf Finance Holdings Limited, has granted a first fixed charge over the shares of CWFII and a first floating charge has been given over all of the assets of CWFII.

In October 1998 the group entered into an agreement for the construction of a headquarters building for the HSBC Group. Liquidated damages are payable by the group in the event that it fails to comply with certain contractual obligations in this agreement by a specified date, which may be extended by force majeure and delay by the HSBC Group. The directors believe that, on the basis of current progress and the building programme, no liability to the HSBC Group will arise under the above provisions.

The group is obliged to make a further contribution to the capital of the company developing Canary Riverside, by way of subscription for additional shares, to enable the company to complete the purchase of the southern parts of Canary Riverside. The maximum amount to be contributed is #2.7 million plus interest.

Commitments of the group for future expenditure: 30 June 30 June 2000 1999 ------- ------- #m #m Under contract 699.6 631.6 ======= =======

The commitments for future expenditure relate to the completion of development properties where construction was committed at 30 June 2000.

Commitments of the group for the next financial year in respect of operating leases are analysed as follows:

Land and Land and buildings buildings 30 June 30 June 2000 1999 ------- ------- #m #m Annual commitment for which the leases expire: Between two and five years 0.7 0.7 After five years 0.2 0.2 ======= =======

Company Names: CWI Holdings PLC